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Income Tax in the WTO – Substantive Reach and Rivaling Proceedings*

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Abstract

This paper considers the intersection of income tax and WTO rules. It defends an interpretation of the non-discrimination obligations in line with customary rules of interpretation as stipulated by the Vienna Convention on the Law of Treaties. It, thus, departs from the historic assumption that income taxes are not or only to a very limited extent covered by the GATT. Subsequently, the reach of the GATS in terms of its non-discrimination obligations and the substantive defenses thereto is assessed. It is analyzed how states may justify their discriminatory income tax measures under the subparagraphs of Article XIV of the GATS. Additionally, the stringency with which measures are assessed under the chapeau of Article XIV is illustrated. The last section of the first part reviews the applicability of the SCM Agreement with respect to income tax measures. It further analyses the scope of the SCM Agreement with respect to transfer price adjustments. Lastly, an interpretation of arm's length in footnote 59 of the SCM Agreement in accordance with the OECD Transfer Pricing Guidelines is defended. Having established the far-reaching scope of the WTO covered Agreements with respect to income tax measures, the second part analyses the rivalry between the respective dispute settlement mechanisms of tax and trade. It dismisses a narrow understanding of jurisdictional overlap that appears to exclusively focus on conflicting judicial decisions and proposes and approach under which the judicial settlement of disputes may rival with the institutionalized diplomatic dispute resolution procedure under tax agreements. Provisions and legal principles that may allow Panels to find income tax disputes inadmissible under the GATT, GATS and SCM Agreement are assessed. The third part reviews, albeit briefly, the appropriateness of the WTO DSB venturing in the field of international income taxation. Considerations are introduced that go beyond the black letter of the law and may ultimately influence the decision to favor an inclusionary or exclusionary approach to income tax measures.

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Introduction

This paper considers the intersection of income tax and WTO rules. For many years tax and trade have been regarded as distinct fields of study.[1] However, this view disregards the multilateral trading system's aim to regulate non-tariff barriers to international trade. These may well comprise cases of income tax discrimination and income tax subsidies. This paper explores the extent to which non-discrimination rules contained in the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS) may regulate discriminatory income tax measures. Additionally, light will be shed on the issue of income tax subsidies, especially where granted by means of approving non-arm's length transfer prices between related entities, which may allow companies to lower their tax burden and thereby gain a competitive advantage in export markets. After establishing the far reach of the substantive WTO obligations, Part II explores the procedural rules governing overlaps between the dispute resolution mechanisms of the multilateral trading system and international income taxation. The dispute settlement procedures of both systems will be introduced. Subsequently, WTO provisions and legal principles that may alleviate potential procedural overlaps are analyzed. Part III explores a number of considerations that exceed the black letter of the law but may help in assessing the appropriateness of the WTO's far reach into Member States' income tax policies. Subsequently, some potential solutions are introduced by way of conclusion.

The proposition that this paper seeks to defend is that an interpretation of the substantive rules of non-discrimination and subsidies in accordance with the provisions of the Vienna Convention on the Law of Treaties (VCLT) serves to establish the far reach of the WTO covered agreements. WTO Members' policy space with respect to income tax measures is curtailed more substantially than often recognized by proponents of arguments that rely on historical assumptions. However, substantive defenses, procedural carve-outs as well as general principles of international law may help to alleviate the problem of

[1] AJ Cockfield and BJ Arnold, 'What Can Trade Teach Tax? Examining Reform Options for Art 24 (Non-Discrimination) of the OECD Model' [2010] 2(2) World Tax Journal 139, p. 145.

rivaling proceedings between tax and trade dispute settlement mechanisms. In any case, the WTO Dispute Settlement Body (DSB) may not be as inappropriate a forum as often feared. Its reach into the field of international income tax may ultimately serve to ensure the achievement of acceptable solutions with respect to income tax measures that unduly restrain international trade.

I. The Applicability of Non-discrimination Obligations and Subsidies Rules to Income Tax Measures

A. Income Tax in the GATT

The following section will discuss the scope of applicability of the GATT non-discrimination rules to income tax measures. The focus will first be on Articles III:2 and III:4, laying down the National Treatment (NT) obligation. Subsequently, the prohibition of quantitative restrictions contained in Article XI will briefly be considered. Lastly, it will be inquired to what extent income tax measures are covered by Article I:1, the Most-Favored-Nation (MFN) Provision.

i. Article III:2

The relevant part of Article III:2 reads as follows:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products.[2]

Any explicit distinction between direct and indirect taxes is absent in the text of Article III:2 and the provision appears to apply to product as well as income taxes.[3] Nevertheless, the argument that Article III:2 exclusively applies to indirect taxes is not uncommon among trade lawyers. The AB acknowledges that

[2] General Agreement on Tariffs and Trade 1994, 1867 UNTS 187 (GATT), Article III:2.

[3] The GATT itself provides no guidance as to the definition of direct or indirect taxes. The Subsidies and Countervailing Measures Agreement, however, which is equally applicable to trade in goods, defines direct taxes as ”taxes on wages, profits, interests, rents, royalties, and all other forms of income”. Alternatively, the General Agreement on Trade in Services , states that direct taxes include “all taxes on total income, on total capital or on elements of income or of capital”. Although neither of these definitions is directly applicable in the current context, direct taxes are defined to include income taxes.

the "principles of interpretation neither require nor condone the imputation into a treaty of words that are not there".[4] Thus, it is necessary to inquire if any distinction between income and product taxes is implicit in the wording adopted by Article III:2.

The customary rules of interpretation,[5] as contained in Articles 31 and 32 of the Vienna Convention on the Law of Treaties,[6] require the determination of "the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose".[7] Only if the approach under Article 31 leaves the meaning ambiguous or obscure is it warranted to have recourse to the *travaux préparatoires* of the treaty in question.[8] Thus, an argument based on historical assumptions about the non-applicability of Article III:2 to direct taxes is unnecessary where Article 31 solves the matter.

As Article III:2 does not, by the ordinary meaning of its terms, limit its scope to indirect taxes, it is necessary to consider the context. Here, according to the AB Article III:1 constitutes relevant context.[9] This provision articulates the fundamental principle underlying the whole of Article III that WTO members may not adopt measures "so as to afford protection to domestic production."[10] Other provisions of the GATT may constitute additional context with regard to Article III:2.[11] If income taxes were considered not to have an impact on the price of goods, the GATT 1947 drafters seem to render certain parts of the GATT useless or at a minimum present contradicting ideas. Article XVI(4), the GATT 1947 provision that historically dealt with export subsidies requires a price differential between exported goods and those that are destined for domestic consumption for a prohibited export subsidy to exist, meaning export prices that

[4] ABR, India-Patents (US), WT/DS50/AB/R, adopted 16 January 1998, para 45.
[5] Understanding on Rules and Procedures Governing the Settlement of Disputes, 1869 UNTS 401 (DSU), Article 3.2 mandates "to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law."
[6] For an early endorsement of the VCLT rules on interpretation as constituting customary law see, for example, ABR, US-Gasoline, WT/DS2/AB/R, adopted 20 May 1996, pp. 16f.
[7] DSU, Article 3.2.
[8] Vienna Convention on the Law of Treaties, 1155 UNTS 331 (VCLT), Article 32(a).
[9] ABR, *Japan-Alcoholic Beverages II*, WT/DS8/AB/R, adopted 1 November 1996, pp. 17f.
[10] GATT, Article III:1.
[11] See, for example, the ABR, *US-Clove Cigarettes*, WT/DS406/AB/R, adopted 24 April 2012, para 173 where it was found that the preamble of the TBT Agreement constitutes relevant context for the interpretation of Article 2.1 of the TBT Agreement.

are lower than comparable domestic prices.[12] The 1960 GATT Working Party report that expressly dealt with this provision foresaw the possibility that the remission of direct taxes in relation to exports constitutes an export subsidy.[13] If direct taxes, however, are considered not to affect the prices of products, such a price differential could never be found, as producers would always retain the income tax subsidy and not lower export prices. Early GATT panel reports, which apply Article XVI(4) found the existence of lower export prices as a result of an income tax subsidy.[14] As no conclusive economic evidence was proffered in any of the cases, this finding was admittedly based on the presumption that the subsidies contained in the illustrative list of the 1960 Report had this effect. Nevertheless, it appears difficult to defend the proposition that for the purposes of Article III product prices are never affected by income tax measures while simultaneously, in the context of subsidies, products prices are affected in the full amount of the subsidy.[15] Thus, if it is considered possible that a direct tax subsidy can result in lower prices, the reverse should logically be possible as well. A discriminatorily higher income tax burden, hence, may result in higher product prices. Therefore, as other provisions of the GATT allow for the possibility that income taxes affect product prices, the context of Article III:2 confirms that income taxes may have an effect on the competitiveness of products and generally fall within the scope of the non-discrimination obligation.

Lastly, the object and purpose of Art. III and the GATT in general, has been found to be "promoting non-discriminatory competition among imported and like domestic products".[16] A stringent distinction between direct and indirect

[12] GATT, Article XVI(4) states: "contracting parties shall cease to grant … any form of subsidy on the export of any product […that] results in the sale of such product for export at a price lower than the comparable price charged for [like domestic products]".
[13] GATT Working Party Report on Provisions of Article XVI:4, L/1381, BISD 9S/185, adopted 19 November 1960, pp. 186f.
[14] GATT Panel Report, *United States-Income tax legislation (DISC)* (1976) GATT BISD 23S/98, adopted 7 December 1981, paras 73f; See also the three related reports GATT Panel Report, *Income tax practices maintained by France* (1976) GATT BISD 23S/114, adopted 7 December 1981, GATT Panel Report, *Income tax practices maintained by Belgium* (1976) GATT BISD 23S/127, adopted 7 December 1981, and GATT Panel Report, *Income tax practices maintained by the Netherlands* (1976) GATT BISD 23S/137 adopted 7 December 1981.
[15] See GATT, Article VI(3) which allows the imposition of countervailing duties up to the amount of the subsidy.
[16] See, GATT Panel Report, *Japan-Customs duties, taxes and labelling practices on imported wines and alcoholic beverages* (1987) GATT BISD 34S/83, adopted 10 November 1987, para 5(5)(c), endorsed by the ABR in *Japan-Alcoholic Beverages II*, pp. 19.

taxes is not only considered questionable from the perspective of economic theory but could also defeat the object and purpose of the provision as it allows states to circumvent the discipline imposed by Article III:2 by simply adopting discriminatory direct tax measures. In fact, "recent empirical evidence suggest[s] that the distinction between direct and indirect taxes … has become rather blurred".[17] In situations where demand exceeds supply, where there is low price elasticity as, for example, in case of live-saving medication, or in the absence of a competitive market for the product in question, it is possible that a producer shifts the direct tax burden forward via increased product prices. Similarly, under the right conditions it is conceivable that indirect taxes are at least partially borne by the producer rather than the consumer. In fact, "there is no commonly accepted method of estimation of the impact of direct taxes on the trade of products."[18] Even within the WTO it was recognized at least as early as 1970 that the issue of incidence of taxation "was full of difficulty and of a very complex nature."[19] More recently, the panel in *Argentina – Hides and Leather* seemed to accept that the incidence of taxation is not always clear cut and it may well be possible that conditions of demand and supply elasticity allow for a shifting of the burden of taxation.[20]

As economic theory concurs that income taxes may affect product prices and, thus, their competitive relationship with like products, the object and purpose supports a wide reading of Article III:2. Therefore, an interpretation of Article III:2 under the customary rules of interpretation appears to lead to the conclusion that both direct and indirect taxes are covered by the aforementioned provision.

As the application of VCLT Article 31 neither leaves the meaning of GATT Article III:2 ambiguous or obscure nor leads to a result that is manifestly absurd or unreasonable, recourse to the *travaux préparatoires* under VCLT Article 32 is not required. However, it is conceded that Article III:2 has historically been

[17] M Daly, 'The WTO and Direct Taxation' (2005) Discussion Paper No. 9, WTO Publications <https://www.wto.org/english/res_e/booksp_e/discussion_papers9_e.pdf> accessed 7 June 2016, p. 23.
[18] GJ Pitsilis and KI Stougiannou, 'National Report Greece' in Lang and others (eds), *WTO and Direct Taxation* (Kluwer Law International 2005), p. 366.
[19] GATT Working Party Report on Border Tax Adjustments, L/3464 (2 December 1970), para 22.
[20] Panel Report, *Argentina-Hides and Leather, WT/DS155/R, adopted 16 February 2001*, para 11.151f and footnote 448.

considered to exclusively apply to indirect taxes.[21] It has been found that "historic assumptions about tax incidence were implicitly adopted" in the GATT.[22] This assumption is buttressed by the fact that the GATT refers to 'products' in contrast to the GATS referring to services and *service suppliers*. "Therefore, by means of historical interpretation, Art. III GATT does not seem to apply to direct taxes."[23] WTO jurisprudence, in complete disregard of DSU Article 3.2 and its mandate to apply customary rules of interpretation, exclusively relying on historical arguments, finds that "income taxes, because they are taxes not normally directly levied on products, are generally considered not to be subject to Article III:2."[24] Nevertheless, the same panel that issued this statement found that income tax measures that provide a sufficient link to products may fall within the ambit of Article III:2. In that particular case, *Argentina – Hides and Leather*, it was found that the collection regime, establishing a 3 percent levy on imported products as an advance income tax was subject to the non-discrimination obligations of Article III:2.[25]

As the above analysis shows, an interpretation in accordance with customary rules reveals that Article III:2 does not draw an artificial distinction between direct and indirect taxes that finds no basis in the text, context or purpose of the provision. Where income tax measures directly, or more likely, indirectly affect products they are subject to Article III:2. Arguments based on the negotiating history appear especially unwarranted in light of the development in economic theory since the adoption of the GATT 1947.

ii. Article III:4

Even if one were to rely on the textually unfounded distinction between direct and indirect taxes for the purposes of Article III:2 and interpret "internal taxes or

[21] See, for example, the preparatory works in Havana Reports, UN Doc ICITO/1/8 (September 1948), p. 63, para 44.
[22] GC Hufbauer, 'Tax Discipline in the WTO' [2010] 44(4) Journal of World Trade 763, p. 769.
[23] M Petritz, 'National Report Austria' in Lang and others (eds), *WTO and Direct Taxation* (Kluwer Law International 2005), p. 143.
[24] Panel Report, *Argentina-Hides and Leather*, para 11.159, relying on the Working Party Report on Border Tax Adjustments, supra 19.
[25] In this context it may be recalled that GATT, Ad Article III provides that a measure applying to imported and like domestic products "and is collected or enforced in the case of the imported product at the time or point of importation, is nevertheless … subject to the provisions of Article III."

other internal charges of any kind" to exclude the former, the much broader language adopted in Article III:4 appears to, nonetheless, cover income tax measures. The weak argument that one should exclusively adopt a historical interpretation does not hold in the context of Article III:4 due to the difference in wording. The provision reads in relevant parts:

> "[imported products] shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use"[26]

Income tax rules are in this context understood to constitute laws and regulations.[27] To understand the scope of application of Article III:4, it is necessary to briefly explain the terms 'affecting' and 'less favorable treatment'.

First of all, with regard to '*affecting'* the Panel in *Italy-Agricultural Machinery* found that "the text … referred … to laws and regulations and requirements *affecting* internal sale, purchase, etc., and *not* to laws, regulations and requirements *governing* the conditions of sale or purchase."[28] Later the AB affirmed this reading by stating that the term affecting has "a 'broad scope of application'".[29] In fact, according to the AB in *China – Auto Parts* the measure need not even be *aimed* at regulating the sale of the product concerned to fulfill the requirement of affecting its sale.[30] Even more broadly, the panel in Canada-Autos, referring back to the GATT 1947 Panel in *Italy - Agricultural Machinery* states that "any laws or regulations which *might* adversely modify the conditions of competition between domestic and imported products" are covered by Article III:4.[31]

Secondly, the provision does not only cover instances of *de jure* less favorable treatment but also applies to *de facto* less favorable treatment. This

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[26] GATT, Article III:4.
[27] P van den Bossche and W Zdouc, *The Law and Policy of the World Trade Organization* (3rd Edition, Cambridge University Press 2013), p. 357 (footnote 31).
[28] GATT Panel Report, *Italy-Discrimination against imported agricultural machinery* (1958) GATT BISD 7S/60, adopted 23 October 1958, para 12 [emphasis by author].
[29] ABR, *US-FSC (Article 21.5)*, WT/DS108/AB/R, adopted 29 January 2002, para 210.
[30] ABR, *China-Auto Parts*, WT/DS339/AB/R, adopted 12 January 2009, para 194, endorsing the findings in Panel Report, *India-Autos*, WT/DS146/AB/R, adopted 5 April 2002, para 7.305.
[31] Panel Report, *Canada-Autos*, WT/DS139/R, adopted 19 June 2000, para 10.80.

may be the case where an origin-neutral measure disproportionally favors domestic over imported goods. Thus, the measure imposes a heavier burden on imported products vis-à-vis like domestic products.[32] Reversely, formally different treatment does not necessarily constitute less favorable treatment.[33] In essence, the concept of 'treatment no less favorable' contained in Article III:4 calls for effective equality of competitive opportunities.[34] It is not necessary to base a finding of less favorable treatment on actual trade effect but potential effects may suffice.[35]

In the following, a number of cases either involving income tax measures or suggesting that Article III may cover income tax measure will be reviewed to illustrate its scope.[36] In the GATT 1947 case *Italy – Agricultural Machinery* the panel reviewed an Italian measure that granted more favorable interest rates for loans that were utilized to purchase Italian agricultural machinery. As the measure favored domestic over imported products, it was found to be in breach of Article III.[37] By analogy it is conceivable that measures, which limit income tax deductions for imported business equipment, or reversely allow for accelerated depreciation in case of domestic goods, are in breach of Article III as they favor domestic products over imports.[38] It is important to bear in mind that this may equally apply to origin neutral measures where they are found to disproportionally impact imported goods.

Another case that reached the WTO but was settled before the panel could issue a report is *Turkey - Taxation of Foreign Film Revenues*. The US requested consultations with Turkey as it taxed the "revenues generated from the showing of foreign films in a manner less favourable than its taxation of revenues

[32] L Ehring, 'De Facto Discrimination in World Trade Law: National and Most-Favoured-Nation Treatment – or Equal Treatment?' [2002] 36(5) Journal of World Trade 921, p. 925.
[33] ABR, *EC-Asbestos*, WT/DS135/AB/R, adopted 5 April 2001, para 100.
[34] Panel Report, *US-Gasoline*, WT/DS2/R, adopted 20 May 1996, para 6.10.
[35] ABR, *Thailand-Cigarettes (Philippines)*, WT/DS317/AB/R, adopted 15 July 2011, para 135.
[36] For different examples of income tax cases submitted to the GATT/WTO see, for example, AH Qureshi, 'Trade-Related Aspect of International Taxation: A New WTO Code of Conduct?' [1996] 30(2) Journal of World Trade 161, pp. 171ff; and M Daly, supra 17 <https://www.wto.org/english/res_e/booksp_e/discussion_papers9_e.pdf> accessed 7 June 2016, 9ff.
[37] GATT Panel Report, *Italy-Agricultural Machinery (1958)*, para 25.
[38] The second example could also potentially be interpreted as a prohibited subsidy under the SCM Agreement.

generated from the showing of domestic-origin films".[39] In particular, a breach of Article III was alleged by the US as Turkey imposed a 25 percent tax on the showing of foreign films. The notification of the mutually agreed solution reads as if Turkey admits its failure to observe the national treatment obligation. The passage "in accordance with Turkey's obligations under Article III …, Turkey will equalize any tax imposed",[40] can only be understood as both members agreeing that Article III bars states from imposing a higher income tax burden in connection with imported products. Neither the Request for Consultations nor the Mutually Agreed Solution explicitly state if the dispute was approached under paragraph (2) or (4) of Article III. However, the wording adopted in the Request for Consultations indicates that the US, correctly or not, considered Article III:4 to be the applicable provision.[41] In any case, the fact that Turkey subsequently instituted a ten percent tax on the showings of all films, regardless of their origin,[42] bears evidence to the fact that both states consider Article III to apply to income tax measures. As no report was issued in the case, however, it is unknown how a panel or the Appellate Body would have approached the issue.

Concerns as to the compliance with Article III:4 of certain US income tax provisions were raised in the *US-FSC* Saga. The AB confirmed that income tax measures which make deductions contingent on the use of a certain percentage of domestic products affect products in the sense of Article III:4.[43] Furthermore, it was found that as fulfillment of the prescribed condition provides "a clearly significant financial benefit in the form of a tax exemption",[44] the measure "provides a considerable impetus, and, in some circumstances, in effect, a requirement, for manufacturers to use domestic input products".[45] Hence, the measure treats imported products less favorably than domestic products.

In *China-Taxes* an agreement between the disputing parties was reached shortly after the establishment of the panel and no report was issued. The US and

[39] Request for Consultations, *Turkey-Taxation of Foreign Film Revenues*, WT/DS43/1, p. 1.
[40] Notification of Mutually Agreed Solution, *Turkey-Taxation of Foreign Film Revenues,* WT/DS43/3.
[41] Note the language in the Request for Consultations, "taxation of revenues … in a manner less favourable" which is parallel to the wording adopted in Article III:4.
[42] D Pulkowski, *The Law and Politics of International Regime Conflict* (OUP 2014), p. 168.
[43] ABR, *US-FSC (Article 21.5)*, para 212f.
[44] Ibid, para 216.
[45] Ibid, para 220.

Mexico instituted proceedings in two separate cases on basis of the same factual circumstances. It was alleged that direct tax refunds, reductions or exemptions are inconsistent with Article III:4 in so far that they treat imported like products less favorably than domestic goods.[46] The dispute was settled in a Memorandum of Understanding by China agreeing to repeal the WTO inconsistent provisions of its Income Tax Law.[47] It is not know how the Panel would have ruled on the matter. Nevertheless, the fact that proceedings were instituted and the subsequent settlement of the dispute appears to confirm the member states' believe that income tax measures fall within the ambit of GATT III:4.

Lastly, and most recently, the Panel in the *Argentina – Financial Services* dispute appeared to set a limit to what measures it considers to affect products. The dispute concerned a total of eight Argentinian measures that were assessed under the GATS and GATT. Only one of the measures, however, was alleged to be in breach of Article III, the requirement to apply the transfer price regime to transactions between Argentinian taxpayers and persons from uncooperative countries despite them being unrelated parties. [48] The tax base of the Argentinian taxpayer was, hence, assessed on basis of the transfer price regime, which in addition to fiscal consequences allegedly resulted in an increased administrative burden. Panama argued that the administrative burden would discourage the purchase of products imported from non-cooperative countries.[49] The panel was unwilling to go so far as to find that this measure affects the sale of imported products.[50] Instead it stated that the previously broad interpretation "of the term 'affect' does not mean that any measure that might hypothetically affect the conditions of competition of hypothetical products could be covered by Article III:4"[51]

This reasoning appears questionable in light of the fact that the Panel earlier found the measure to affect trade in services in the sense of GATS Article

[46] Request for Consultations, *China-Taxes*, WT/DS358/1 (2 February 2007), p. 3.
[47] Notification of Mutually Agreed Solution, *China-Taxes*, WT/DS358/14 (4 January 2008), p. 3.
[48] Panel Report, *Argentina-Financial Services*, WT/DS453/R (30 September 2015), para 2.19.
[49] Ibid, para 7.1027.
[50] Ibid, para 7.1028.
[51] Ibid, para 7.1028.

I:1.[52] When determining the scope of the term 'affecting' in the context of GATS I:1, the AB relied on earlier jurisprudence under GATT Article III:4, indicating that the respective scopes of the two provisions are similar.[53] The measure itself does not distinguish between goods and services but applies to any transaction. Hence, it is unclear how the measure 'affects' transactions relating to the purchase of services but does not 'affect' transactions relating to the purchase of goods. If anything, it appears easier to defend the proposition that the measure does not fall within the scope of Article III:4 as it does not affect the *internal* sale, offering for sale, *et cetera*. The measure would then rather impact the decision to import goods from non-cooperative countries in the first place and not their competitive opportunities in the domestic market. This part of the report, however, was not appealed and it is, thus, unknown if the Panel's assessment would have withstood scrutiny by the AB.

The opinion that most income tax measures will not sufficiently affect products so as to be subject to the NT obligation in Article III is not uncommon in academic writing.[54] However, it should also be clear from the above that a large number of income tax measures seemingly not within the scope of Article III may be subject to scrutiny under said provision if properly interpreted. Earlier academic writing discounted the potential reach of Article III too quickly whether by falsely relying on a historical interpretation of Article III:2 or by underestimating the ease with which the AB finds measures to 'affect' products in the sense of Article III:4.

iii. Article XI – Prohibition of Quantitative Restrictions

Before analyzing the obligation not to discriminate between foreign products, GATT Article I:1, it is necessary to briefly point out a number of issues arising under Article XI. The placement of this section is appropriate as the analysis mainly concerns problems raised in the *Argentina-Financial Services* dispute

[52] The Panel stated in *Argentina-Financial Services*, para 7.104 with respect to GATS Article I:1 that it "does not require the complainant to prove the existence of specific services or service suppliers, or the existence of actual transactions." It is unclear how a transaction that is not actual is anything but hypothetical/potential.
[53] ABR, *EC-Bananas III*, WT/DS27/AB/R, adopted 25 September 1997, para 220.
[54] See, for example, M Lennard, 'The GATT 1994 and Direct Taxes: Some National Treatment and Related Issues' in Lang and others (eds), *WTO and Direct Taxation* (Kluwer Law International 2005), p. 101.

considered above. Article XI, entitled General Elimination of Quantitative Restrictions, bans any prohibition or restriction other than duties, taxes or other charges on the import or export of products.[55] The Argentinian measure concerning transfer prices for transaction with persons in non-cooperative countries was, in the alternative to Article III:4, challenged under Article XI. In the context of Article XI the term 'restriction' refers to "something that has a limiting effect."[56] Thus, the AB found "Article XI of the GATT 1994 covers those prohibitions and restrictions that have a limiting effect on the quantity or amount of a product being imported or exported."[57] By its own words, and reiterated by the AB, the provision does not apply to 'duties, taxes or other charges'.[58] In *Argentina-Financial Services* the Panel found that the application of the transfer price regime to transactions with residents of non-cooperative countries constituted a fiscal measure and, thus, was not covered by Article XI.[59] The Panel's reasoning seems to be mistaken in so far as Article XI appears not to exclude any 'duty, tax or other charge'. In fact, it outlaws only those duties, taxes or charges in relation to the importation or exportation of goods. Hence, it applies to price-based mechanisms that make imports or exports less attractive. To find otherwise would provided a tool to WTO members to uninhibitedly restrict imports from other members as long as the restriction is somehow related to an income tax measure and preferably contained in the state's income tax legislation. The challenged measure in *Argentina-Financial Services* was not a 'duty, tax or other charge' that increased prices and made imports less attractive but an administrative requirement prescribing a specific methodology to calculate an importer's tax base. Hence, it was not the amount of the tax imposed but the manner in which the tax was calculated that was challenged by Panama.

Therefore, considering the wording of the provision as well as its purpose, it appears more consistent to find that Article XI prohibits any measure that has a limiting effect on imports or exports unless the measure is an actual duty, tax or other charge. An administrative requirement connected to the calculation of said

[55] GATT, Article XI.
[56] ABR, *China-Raw Materials*, WT/DS394/AB/R, adopted 22 February 2012, para 319.
[57] Ibid, para 320.
[58] Ibid, para 321.
[59] Panel Report, *Argentina-Financial Services*, para 7.1067.

duty, tax or other charge does not fall within this exception. As this section of the Panel report was not appealed, the AB was not compelled to reveal its thoughts on the matter.

iv. Article I:1 – MFN Treatment

The most-favored-nation obligation with respect to goods is set out in Article I:1 of the GATT. Most importantly for the purposes of this paper, Article I:1 covers all matters falling within the scope of Articles III:2 and III:4 of the GATT.[60] Thus, to the extent that income tax measures fall within the purview of the national treatment obligation, they are equally subject to the obligations set out in Article I:1. Much like Article III, the provision is concerned with the protection of expectations of equality of competitive opportunities between like imported products[61] and applies to *de facto* and *de jure* less favorable treatment.[62] The above examples, hence, could equally be applicable in an MFN context where the measure distinguishes between products on basis of their different foreign origins.

More interestingly, however, is the question if the GATT MFN clause is applicable to the different treatment resulting from double taxation agreements (DTAs).[63] At this point in time, no different treatment resulting from a DTA has ever been challenged in front of the WTO DSB. However, as enforcement of the WTO obligations is driven by its members, it is possible that the lack of complaints is not the consequence of the compatibility with Article I:1 but rather results from the members' unwillingness to potentially trigger an avalanche of claims.

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[60] In the Panel Report, *Argentina-Financial Services* Panama unsuccessfully argued that certain income tax measures constitute charges imposed in connection with exportation or alternatively rules and formalities in connection with exportation (see paras 7.980-7.1008 for the Panels analysis). Such specific cases, however, exceed the scope of the present analysis.
[61] ABR, *EC-Seal Products*, WT/DS400/AB/R, adopted 18 June 2014, para 5.88.
[62] ABR, *Canada-Autos*, WT/DS139/AB/R, adopted 19 June 2000, para 78.
[63] DTAs are defined broadly here to include any binding international agreement that includes provisions on the avoidance of double taxation. It is estimated that there are currently some 3000 plus bilateral agreements. A limited number of multilateral agreements are currently in force such as the Decisión 578 de la Comision de la Comunidad Andina, Régimen para evitar la Doble Tributación y Prevenir la Evasión Fiscal (adopted 5 May 2004, entered into force 1 January 2005) or the SAARC Limited Multilateral Agreement on Avoidance of Double Taxation and Mutual Administrative Assistance in Tax Matters (adopted 12 November 2005, entered into force 31 March 2007).

Double taxation arguably has trade distortive effects and as DTAs generally seek to eliminate double taxation, one may wonder if this does not constitute an advantage in the sense of Article I:1. Different, legally questionable arguments have been brought forward to find that MFN treatment is not applicable to DTAs. It has been argued, for example, that the conflict between DTAs and MFN treatment has not been raised in such a long period that subsequent practice in the sense of VCLT Article 31(3)(b) constitutes an implicit agreement "that WTO Members did not intend to affect DTCs [Double Taxation Conventions] when enacting the GATT MFN clause."[64] This argument cannot be accepted. It is necessary to draw a distinction between mere conduct and practice. The practice has to be linked to the acting parties believe that its conduct constitutes a particular position taken in the interpretation of the treaty.[65] It is difficult to establish the existence of this believe on part of the WTO members, especially as the subsequent practice is merely reflected in the abstention from action and occurs entirely outside the WTO. Furthermore, the Panel in *Guatemala-Cement II* explicitly dismissed Guatemala's argument that a Member waives its right to object to a violation where it does not do so at the earliest possible moment.[66] Therefore, the above argument needs to be rejected.

Others have attempted to rely on the historic assumption that MFN clauses in trade agreements are inapplicable to tax treaties. In 1930 "the Financial Committee of the League of Nations suggested that future trade agreements should contain a special clarification that the most-favored-nation treatment clauses in trade agreements do not apply to double tax conventions."[67] The argument of inapplicability is derived from the use of the term 'clarification'.[68] Despite of the legal weakness of such arguments there appears to be broad agreement that Article I of the GATT does not apply to tax treaty

[64] B Liszicza, 'National Report Hungary' in Lang and others (eds), *WTO and Direct Taxation* (Kluwer Law International 2005), pp. 388f, the author relied on a period of 57 years in which the argument has not been raised.
[65] ICJ, *Case Concerning Kasikili/Sedudu Island (Botswana v Namibia)* (Merits) [1999] ICJ Rep 1045, para 74.
[66] Panel Report, *Guatemala-Cement II*, WT/DS156/R adopted 17 November 2000, paras 8.23-24.
[67] TK Stricker, 'National Report Germany' in Lang and others (eds), *WTO and Direct Taxation* (Kluwer Law International 2005), p. 323.
[68] Ibid.

provisions.[69]

To identify why the different tax withholding rates of DTAs do not constitute an advantage in the sense of GATT Article I:1 and are, thus, not legally challengeable under the GATT requires some background regarding DTAs and double taxation more broadly. Generally, the country in which profits arise has physical jurisdiction to tax, regardless of these profits being characterized as active or passive income. Without a physical presence of the taxpayer, it is virtually impossible to impose an income tax. Even controlled foreign corporation (CFC) rules, for example, in the United States tax residents on a deemed dividend originating from the CFC. These rules do not tax the actual income of foreign companies but instead resident shareholders with a controlling interest.[70]

States can unilaterally choose to mitigate or provide relieve from double taxation through different domestic mechanisms.[71] DTAs add an additional layer of sophistication to the prevention of double taxation. They do so by assigning taxation rights between countries, by defining types of income, setting residence rules, and providing for maximum tax withholding rates for different types of income.

It is necessary to understand that double taxation is not the result of measures that affect goods within one market place but rather results from the treatment of the same profits by two different countries. Where two countries have jurisdiction to tax and exercise this right with respect to the same profits double taxation occurs. DTAs seek to prevent this. Above it has been argued that the income tax burden may affect competitive opportunities of products. DTAs, however, do not influence the tax burden borne by goods within one country. Double taxation or the absence thereof is not the result of a measure applied to goods in circulation in the domestic market of a member. They are not internal taxes falling within the ambit of the non-discrimination provisions of the GATT.

[69] S van Thiel, 'General Report' in Lang and others (eds), *WTO and Direct Taxation* (Kluwer Law International 2005), p. 23.
[70] For a brief explanation and placing of CFC rules in their historical context see RS Avi-Yonah, *International Tax as International Law: an Analysis of the International Tax Regime* (Cambridge University Press 2007), pp. 24ff.
[71] For a brief overview of different unilateral methods see P Harris and D Oliver, *International Commercial Tax* (Cambridge University Press 2010), pp. 266ff.

Even where DTAs incidentally affect the competitive opportunities of foreign products vis-à-vis other foreign products or domestic goods they are not subject to the GATT discipline set out in Articles I:1. In *Dominican Republic – Import and Sale of Cigarettes* the AB clarified that a detrimental effect on competitive opportunities does not always result in a finding of less favorable treatment "if the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product."[72] Here, any incidental impact on competitive opportunities would be the result of the residence of the recipient of the profits, regardless of the origin of the goods. As in the case of foreign goods, it is quite common that profits arising from the sale of domestic goods are repatriated to another country. One can imagine the case of a subsidiary that generates profits by producing and selling goods in one state. Subsequently, these profits are distributed to the parent company by means of a dividend. The amount of withholding tax will depend on the existence of and conditions in a DTA between the two residence states of parent and subsidiary respectively. It is possible that tax agreements, thus, have an effect on the overall tax burden and indirectly affect a products competitive opportunities. This effect, however, is unrelated to the origin of the goods and can be explained by other factors, namely, the residence of the taxpayer. Therefore, it can be said that the potential competitive advantage granted by the reduction or absence of double taxation as a result of a DTAs do not fall within the scope of the MFN clause of the GATT.

To conclude on the non-discrimination provisions of the GATT, any measure that *de facto* or *de jure* favors domestic over imported goods or goods of different foreign origins by lowering the tax base, the applicable tax rate or by imposing an unreasonable administrative burden may come within the reach of Articles III and I:1. As this impact need only be potential, even where the market conditions do not result in a forward shifting of the income tax burden via product prices, the non-discrimination obligations are applicable. Since governments increasingly recognize the importance of tax reform to prevent tax evasion, those states that see themselves and their products targeted by such action, whether taken unilaterally or as a concerted effort of a group of states

[72] ABR, *Dominican Republic-Import and Sale of Cigarettes*, WT/DS302/AB/R, adopted 19 May 2005, para 96; The statement was made in the context of Article III:4. Nevertheless, the reasoning applies analogous to Article I:1.

such as the OECD members, will increasingly recognize the WTO as a forum to challenge such measures. Therefore, it is of utmost importance that policymakers aim to develop and implement *de facto* and *de jure* non-discriminatory anti-tax avoidance measures. This way a potential rollback of tax avoidance measures by means of a challenge in the WTO DSB can be avoided.

v. Article XX

Article XX provides a substantive defense with regard to measures that are found to be incompatible with the obligations set out in the GATT. Although there is no explicit reference, Article XX(d) may serve to justify income tax measures or related administrative practices that do not comply with the GATT provisions where they are "necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of [the GATT]".[73] The Panel in *Argentina – Hides and Leather* examined the compatibility of an income tax measure with Article XX(d). It found amongst others that it was necessary to secure compliance with Argentinian income tax rules.[74] However, the measure ultimately failed the test under the Chapeau of Article XX.[75] More detail as to the way in which Article XX(d) and the chapeau operate will be provided below. Although the GATS and GATT provisions cannot be equated in all respects for the purposes of this paper, they are sufficiently similar.

vi. Transfer Price Adjustments and GATT Non-discrimination Rules

This section seeks to apply the general considerations on discriminatory income taxes to the concrete issue of (im)proper transfer pricing between related entities. Where one enterprise establishes multiple presences in different tax jurisdictions whether by means of a subsidiary or permanent establishment it may shift profits from one jurisdiction to another by artificially determining the price it charges for goods or services provided to related entities. Base erosion may occur where, for example, a company buys products at inflated prices from foreign affiliates or underprices the products it sells to its foreign affiliates. In both cases the company effectively shifts profits out of the reach of tax

[73] GATT, Article XX(d).
[74] Panel Report, *Argentina – Hides and Leather*, para 11.308.
[75] Ibid, para 11.330.

authorities. It is no surprise that countries generally object to such practices by its residents. To preserve the domestic tax base, tax authorities generally have the power to make determinations as to the appropriateness of transfer prices for goods or services provided by related entities. Where these are considered not to reflect the prices that would have existed if the related entities had acted at arm's length, competent authorities may make appropriate adjustments to determine a company's taxable income. The following section will review the applicability of the GATT non-discrimination provisions to transfer price adjustments as well as provide examples of practices that may potentially find challenge under these provisions.

First of all, it needs to be established that the GATT non-discrimination provision applies to the issue of transfer prices, as generally products need to be affected for the NT and MFN obligations to be triggered. It is, thus, necessary to determine the circumstances under which the application of a transfer-pricing regime adversely modifies the conditions of competition of imported products.

One may imagine the situation where a taxpayer purchases tax-deductible foreign goods. If the tax authority now applies the transfer pricing regime to these goods and finds that the tax resident paid an inflated price it may adjust the transfer price downward for the purposes of determining the tax base and, hence, the income tax burden. This is not an adjustment of the price actually paid but only serves the purposes of calculating the income tax base. The tax resident is no longer allowed to deduct the full expense but only the price determined by the competent authority, which, in case of a downward adjustment, increases the income tax burden and from the perspective of the purchaser of the goods, the price of the imported goods.

The following example may help to illustrate this situation. A car manufacturer purchases $1000 worth of components. Assembly of these components and sale of the finished product result in additional costs of $800. The manufacturer is able to sell an assembled car for $2000. The taxable profits of the manufacturer are, thus, $200. At a tax rate of 40 percent, the manufacturer is left with $120 net profits. If the tax authority were to decide that the manufacturer overpaid for the components and adjusts the transfer price to $500, the manufacturer can only deduct $500 for car components and $800 of

costs incurred in the assembly and sale of the components. If the finished product is sold at $2000, the car manufacturer will, thus, have $700 of taxable profits. At a rate of 40 percent, the manufacturer pays total income tax of $280. Here the manufacturer is left with a net loss of $80 ($1000 for the components, $800 for assembly and sale and $280 taxes). Put differently, the adjustment increased the net price of the components by $200, as the full purchase price of the components is no longer tax deductible. Hence, from the perspective of the manufacturer the transfer price adjustment made the components more expensive.

Usually, such adjustments only occur with respect to foreign goods. From the perspective of the tax authorities the transfer price of domestic goods is, assuming a single corporate income tax rate, irrelevant as both, the producer of the components and the manufacturer of the car will be taxed domestically. The profits will not leave the country. Where the components are not produced domestically, however, an inflated price will have the result of eroding the domestic tax base. As tax authorities seek to prevent this, they adjust transfer prices. Where the adjustment is justified, arguably no detrimental impact on competitive opportunities can be found. Where such an adjustment is unjustified, however, a detrimental impact on competitive opportunities can be observed.

The above example of the car manufacturer serves to illustrate this point. One can imagine the case that the proper transfer price for the components should have been $1000 and not as the tax authority determined $500. In other words, the competent authority made an unjustified transfer price adjustment. Imported components, because of the resulting adjustment to the manufacturer's tax base, are less competitive than domestic components or components from countries where transfer prices are not adjusted downwards. The decision to purchase imported components whose transfer price is adjusted directly results in an increased income tax burden of $200. An impact on the competitive opportunities of the imported components is, thus, discernable. Put bluntly, car manufacturers prefer a $120 net profit to an $80 net loss and all they need to do is use domestic components.

Where a competent authority improperly increases the tax base and, hence, the net price of the foreign good, a detrimental impact on competitive opportunities of foreign products, thus, exist. As Article III:4 is generally considered to also apply to isolated cases as opposed to general legislation,[76] such practice could be challenged. Furthermore, where competent authorities regularly make improper adjustments with respect to the products of certain WTO members while disregarding transfer prices of others, issues with respect to the MFN obligation could be found. The difficulty in the latter case, indeed, would be for the complainant to establish that such practice occurs systematically. The legal issue with respect to the NT and MFN clauses, however, is to first determine where the line can be drawn between justified and unjustified transfer price adjustments.

It is, thus, necessary to determine a point of reference for proper transfer price adjustments. Generally, this point of reference can be found in the principle of arm's length. The international consensus appears to be that transfer prices need to conform to the principle of arm's length and adjustments, hence, would be improper where they depart from this principle. It remains to be established, however, on what basis this principle is applicable in the context of the GATT as the Agreement itself does not contain any reference to arm's length.

It has been argued that the arm's length principle constitutes a rule of customary law.[77] If this were the case the principle could be read into the term less favorable treatment by means of VCLT Article 31(3)(c) and any adjustment that disregards the arm's length principle would be in breach of the non-discrimination obligations under the GATT. However, it appears questionable from the point of view of public international law that the principle, despite its widespread acceptance, can be regarded as a rule of international law as *opinio juris* and state practice are not as easily established as the proponent of the argument makes it seem.

Alternatively, it is proposed that the context of GATT Article III provides sufficient reason to interpret treatment no less favorable to incorporate the

[76] GATT Panel Report, *Canada-Administration of the Foreign Investment Review Act* (1983) GATT BISD 30S/140, adopted 7 February 1984, para 5.5.
[77] RS Avi-Yonah, supra 70, p. 113 where the author states, "customary international law…embodies the arm's length standard."

standard of arm's length. In the past, the Appellate Body has referred to related provisions, even where they are contained in other agreements,[78] to establish or confirm a certain interpretation.[79] Other Agreements contained in Annex 1A such as the SCM Agreement and the Customs Valuation Agreement explicitly refer to arm's length. The SCM Agreement does so in its footnote 59 where it provides that "[t]he Members reaffirm the principle …[of] arm's length".[80] Furthermore, the Customs Valuation Agreement requires the application of the principle as evidenced by its Article 1(2).[81] Thus, arm's length appears to be the applicable standard elsewhere with respect to trade in goods. It is further suggested that the transfer pricing guidelines of the Organisation for Economic Co-operation and Development (OECD) may provide guidance in the establishment of arm's length and, hence, ultimately less favorable treatment. The different legal arguments by which a panel may rely on the OECD guidelines as well as their respective legal merits will be explored in the context of income subsidies below.

The question of transfer price documentation may raise concerns that are related but differ from those arising in the context of transfer price adjustments. Excessively burdensome documentation requirements could find challenge under the non-discrimination provisions of the GATT. In *Colombia-Customs Measures on Importation of Certain Goods from Panama* the complainant raised the issue that commercial invoices for certain goods from Panama needed to provide additional information exceeding what was usually required.[82] Furthermore, the commentary to Article 7 of the OECD Model Tax Convention (OECD MTC) provides that transfer pricing documentation "requirements should not be applied in such a way as to impose on taxpayers costs and burdens

[78] See, for example, AB, *US-Clove Cigarettes*, para 176 where the AB referred to the GATT to determine the meaning of Article 2.1 of the TBT Agreement.
[79] See generally on the technique of cross-referencing as employed by the AB, I van Damme, *Treaty Interpretation by the WTO Appellate Body* (OUP 2009), pp. 235ff.
[80] SCM Agreement, footnote 59, second sentence.
[81] Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (Customs Valuation Agreement), 1868 UNTS 279, Article 1(2).
[82] Request for Consultations, *Colombia-Customs Measures on Importation of Certain Goods from Panama*, WT/DS348/1 (20 July 2006), p. 2; the Mutually Agreed Solution was notified before a Panel was established.

disproportionate to the circumstances." [83] Although it is conceivable that disagreement arises as to the line between proportionate and disproportionate requirements, it appears undisputable that significantly more burdensome requirements imposed on goods originating in specified jurisdictions discriminate in contravention of the MFN obligation. It seems possible, however, that a state may justify such measures under Article XX(d) where the specific relationship between the trading partners, for example the absence of an agreement on the exchange of information, warrants more burdensome requirements. If such a defense is successful will, in all likelihood, depend on the respondent's ability to justify the measure under the chapeau of Article XX.

Lastly, it is necessary to briefly address the connection between transfer prices and customs duties. From the perspective of the importing country, under-invoicing poses a concern as it avoids the payment of proper customs duties. From the perspective of tax authorities, however, it is over-invoicing, meaning inflated transfer prices, which are of concern as this decreases the domestic income tax base. If a company over- or undercharges for goods when selling to a foreign related entity will depend on the interplay between the level of customs duties and the income tax rate in both countries. It has been observed that "[c]ooperation between income tax and customs administrations … is becoming more common and this should help to reduce the number of cases where customs valuations are found unacceptable for tax purposes or vice versa." [84] The methodologies for customs valuation and transfer price adjustments are, however, not necessarily the same. Furthermore, even where the same methodology is applied, the situation where a country excessively relies on transfer pricing data to establish the customs duty and disregards the rules of the Customs Valuation Agreement might be challenged in WTO dispute settlement.[85] There is no rule in the GATT, however, that prevents a country from valuing goods in accordance with the methodology established by the

[83] OECD, *Model Tax Convention on Income and Capital 2014* (OECD Publishing 2015) (OECD Model Tax Convention), Commentary to Article 7, para 26.
[84] OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project* (OECD Publishing 2015), p. 43.
[85] L Bastin, 'Transfer Pricing and the WTO' [2014] 48(1) Journal of World Trade 59, pp. 79f.

Customs Valuation Agreement [86] and applying the same or a different methodology for the purposes of income tax transfer price adjustments.

B. Income Tax in the GATS

i. Applicability of Non-discrimination Obligations to Income Tax Measures

a. Most-Favored-Nation Treatment

The GATS Most-Favored-Nation obligation can be found in Article II(1) which provides:

> "With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country."[87]

As the Article expressly applies not only to services but also service providers, there is little doubt that income tax measures are covered by Article II(1). Furthermore, the substantive defense contained in GATS Article XIV(e), discussed below, would be redundant if the MFN obligation would not apply to income tax measures. As opposed to the GATT, the GATS contains its own definition on direct taxes which expressly includes income taxes.[88]

Despite the great similarities to GATT III:4 such as the fact that GATS II(1) also covers *de jure* and *de facto* less favorable treatment[89] and essentially concerns the equality of competitive opportunities,[90] it is not possible to directly transpose the jurisprudence developed under the Agreements relating to trade in goods.[91] Equally the concept of likeness has been interpreted somewhat different in the GATS as the criteria developed under the GATT are only of limited help.[92] Not even the well-established test of hypothetical likeness,[93]

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[86] Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (Customs Valuation Agreement), 1868 UNTS 279.
[87] GATS Article II(1).
[88] GATS, Article XXVIII(o).
[89] ABR, *EC-Bananas III*, para 234.
[90] Panel Report, *EC-Bananas III*, WT/DS27/R, adopted 25 September 1997, para 7.304.
[91] Panel Report, *Argentina-Financial Services*, para 7.231.
[92] See generally M Cossy, 'Some Thoughts on the Concept of 'Likeness' in the GATS' in M Panizzon and others (eds), *GATS and the Regulation of International Trade in Services* (Cambridge University Press 2008).

which provides for a presumption of likeness in case of discrimination on basis of origin, is simply transposable to the GATS. The AB recently found in *Argentina – Financial Services* that establishing origin-based discrimination is of a more complex nature in the context of the GATS and the presumption of likeness is of a more limited scope.[94]

Most interesting with regard to income tax measures is GATS Article II(2) which provides that Members may under certain circumstances exempt measures by including them in the Annex on Article II exemptions.[95] In principle these exemptions should not be granted for more than 10 years.[96] However, almost none of the estimated more than 400 exemptions provide for a definite end-date.[97] There are 17 members that "chose to submit tax exemptions and, with the exception of the United States, these exemptions are narrowly drafted."[98] Under the US exemption, all direct tax measures are immune from challenge under the MFN treatment clause.[99]

b. National Treatment

Generally, Article XVII provides for National Treatment. However, it is only applicable to the extent that a member has scheduled specific commitments. It reads as follows:

> "In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers."[100]

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[93] See, for example, Panel Report, *Argentina-Import Measures*, WT/DS438/R, adopted 26 January 2015, para 6.274 or Panel Report, *Canada-Autos*, para 10.74.
[94] ABR, *Argentina-Financial Services*, WT/DS453/AB/R (14 April 2016), para 6.38-41.
[95] GATS Article II(2).
[96] Annex on Article II Exemptions, para 6.
[97] ME Footer, 'The General Agreement on Trade in Services: Taking Stock and Moving Forward' [2002] 29(1) Legal Issues of Economic Integration 7, p. 24.
[98] J Farrell, *The Interface of International Trade Law and Taxation* (IBFD 2014), p. 185.
[99] United States of America Final List of Article II (MFN) Exemptions, GATS/EL/90 (15 April 1994), pp. 2ff.
[100] GATS, Article XVII(1).

There is no doubt that the provision is applicable to direct taxes as Article XIV(d) provides for a substantive defense with respect to direct tax measures aimed at the equitable and effective collection of taxes.[101] Additionally, Article XXII(3) bars members from invoking Article XVII, the National Treatment provision, with respect to measures that fall within the scope of a DTA.[102] Article XXII(3) does not, however, prevent a WTO member from invoking the MFN provision. Both, exceptions will be discussed further below. Though the *travaux préparatoires* of the GATS are not readily available, the accessible documents indicate "tax experts… felt so strongly about the matter that they were able to force late changes… despite concerns… that his demand could unravel the GATS as a whole."[103] As stated above, however, the GATS national treatment obligation only applies to the extent that a member has made a specific commitment with regard to a sector and mode of supply.

There is a wide range of examples of national rules that potentially violate GATS Article XVII such as an Italian rule that grants taxpayers benefits from a tax allowance for interest paid on loans that were used to finance agricultural activities or the acquisition of an abode. Problematic may be that the loans have to be granted by an EU Member resident or Italian permanent establishment of a non-EU resident taxpayer as the rule "could discriminate those financial institutions that do not provide financial services by means of a commercial presence in Italy."[104] Where the interest on a loan is not deductible, the loan becomes more expensive from the taxpayer's perspective. This constitutes an advantage for the providers of loans with deductible interest, as taxpayers would clearly favor such loans at comparable interest rates. Another example comes from UK tax legislation. Lessees of non-resident landlords are required "to deduct tax at source from the rental paid and at the same time pay the tax due by the non-resident landlord".[105] Tenants who are renting from UK residents,

[101] GATS, Article XIV(d.
[102] GATS, Article XXII(3).
[103] Lennard, supra 54, p. 81 (footnotes omitted).
[104] G Cappadona, 'National Report Italy' in Lang and others (eds), *WTO and Direct Taxation* (Kluwer Law International 2005), p. 439.
[105] C Väljemark, 'National Report United Kingdom' in Lang and others (eds), *WTO and Direct Taxation* (Kluwer Law International 2005), p. 713.

however, are not required to do so and "simply pay the gross rent."[106] It appears that the rule disfavors non-resident landlords and might potentially violate the GATS NT provision.

Having ascertained that income tax measures clearly fall within the ambit of the GATS non-discrimination provisions, it will not be elaborated on the mechanics and substance of both Articles II and XVII. Instead the focus will be on the defenses provided under GATS Article XIV.

ii. Substantive Defenses in GATS Article XIV

This section reviews the applicability of the general exception clause to income tax measures that have been found to be in violation of either the MFN or NT provision of the GATS. Generally GATS Article XIV has been interpreted similarly to GATT Article XX and jurisprudence under the latter may, thus, be of relevance to the analysis of the former.[107] The provision prescribes a two-tier analysis where first, the measure needs to fall within the ambit of one of the subparagraphs and secondly, comply with the requirements of the chapeau of Article XIV.[108] The defending party bears the burden of proof with regard to the entirety of Article XIV.[109] In the following potentially applicable subparagraphs as well as the chapeau of Article XIV will be considered in more detail.

a. GATS Article XIV(c)

GATS Article XIV(c) applies to measures "necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement".[110] As its GATT counterpart, Article XX(d), the provision may serve to justify violations of the MFN and NT clauses. Although no direct reference to income tax rules can be found, in *Argentina – Financial Services* Argentina's discriminatory income tax measures fell within the scope of subparagraph (c). Thus, it can generally be said that laws and regulations encompass income tax rules.[111]

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[106] Ibid.
[107] ABR, *US-Gambling*, WT/DS285/AB/R, adopted 20 April 2005, para 291.
[108] Ibid, para 292.
[109] Ibid, para 282.
[110] GATS, Article XIV(c).
[111] Panel Report, *Argentina-Financial Services*, para 7.538.

Under the provision, the member invoking the defense "bears the burden to identify the domestic laws or regulations relevant to its… defence."[112] In addition to domestic rules those "rules deriving from international agreements that have been incorporated into the domestic legal system of a WTO Member or have direct effect according to that WTO Member's legal system" are covered by the provision.[113] Hence, where individuals may directly, in the domestic courts of a member, rely on the provisions of a DTA, these are included within the scope of Article XIV(d). However, where action has been taken pursuant to a framework convention that seeks to, for example, battle tax avoidance and the provisions of the international agreement cannot be relied upon in the domestic courts of the defendant, they are excluded from the scope of GATS Article XIV(c).[114] Similarly, measures that secure compliance with the objectives of a domestic law or regulation rather than the law or regulation itself are not covered. Once the respondent's law or regulation has been identified it "will be treated as WTO-*consistent* until proven otherwise."[115]

The term 'necessary' has been described to impose an objective standard[116] that is "significantly closer to the pole of 'indispensable' than to the opposite pole of simply 'making a contribution to'".[117] Generally, a weighing and balancing exercise is undertaken. The relative importance of the interests or values at stake is assessed and weighted against "the contribution of the measure to the realization of the ends pursued by it and the restrictive impact of the measure on international commerce".[118] Perhaps most important, the analysis of a measure's necessity entails an assessment of the availability of less trade restrictive alternatives.[119] It is on the complainant to indicate the existence of

[112] Panel Report, Colombia-Ports of Entry, WT/DS366/R, adopted 20 May 2009, para 7.520; the finding emanates from a discussion of Article XX of the GATT but equally applies in the present context.
[113] ABR, *Mexico-Taxes on Soft Drinks*, WT/DS307/AB/R, adopted 24 March 2006, para 79; though the report discussed GATT Article XX the finding equally applies here.
[114] See the discussion in Panel Report, *India-Solar Cells*, WT/DS456/R (24 February 2016), paras 7.299-300, the decision is under appeal at the time of writing.
[115] ABR, *US-Carbon Steel,* WT/DS213/AB/R, adopted 19 December 2002, para 157 (emphasis in original).
[116] ABR, *US-Gambling*, para 304.
[117] ABR, *Korea-Various Measures on Beef*, WT/DS161/AB/R, adopted 10 January 2001 para 161.
[118] ABR, *US-Gambling*, para 306.
[119] Ibid, para 310.

such alternatives and the respondent to challenge the availability thereof.[120] Where a less trade restrictive alternative is reasonably available, a measure is considered not to be necessary.

b. GATS Article XIV(d)

GATS Article XIV(d) may serve to justify measures "inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members".[121] Additionally, footnote 6 provides a non-exhaustive list of measures that fall under subparagraph (d). [122] Most importantly, Article XIV(d) exclusively applies to violations of the NT provision and may not be invoked to justify a failure to observe any of the other substantive GATS obligations such as the MFN clause. In light of the lack of jurisprudence on the matter it is unclear what standard of relationship the criterion of 'aimed at' establishes. Assessing the term 'relating to' contained in GATT Article XX(g),[123] the AB found "[w]hile measures need not be *primarily aimed at* conservation, they must still bear a substantial, close, and real relationship"[124] Although GATS Article XIV(d) does not require measures to be '*primarily* aimed at', it is conceivable that 'aimed at' requires a stronger connection than 'relating to' and, thus, at a minimum there needs to be "a close and genuine relationship of ends and means".[125] Equally, it is possible that the term will be interpreted to require a lesser degree of connection than 'necessary' as contained in GATS Article XIV(c) and discussed above. The different standards become important where multiple subparagraphs are invoked and a party fails to meet the more stringent requirements of one of them.

Footnote 6 provides a fairly detailed insight as to what measures are included within the ambit of subparagraph (d). Additionally, it specifies that for defining tax terms under Article XIV(d), including footnote 6, Panels and the AB

[120] Ibid, para 311.
[121] GATS, Article XIV(d).
[122] GATS, Article XIV(d), footnote 6.
[123] For measures to be justified under Article XX(g) of the GATT they *inter alia* need to relate to the conservation of exhaustible natural resources.
[124] ABR, *China-Rare Earths*, WT/DS431/AB/R, adopted 29 August 2014, para 5.114 (emphasis by author).
[125] ABR, *China – Raw Materials*, para 355.

shall defer to the domestic laws of the defending party.[126] This constitutes an important clarification as much debate may arise out of diverging definitions of tax terms and concepts. However, difficulties may arise where there is a divergence between domestic definitions and those directly contained in the GATS itself, for example, direct taxes.[127] Equally, though the term resident is not explicitly defined in the GATS, certain definitions in Article XXVIII appear to provide guidance as to the concept. Ultimately, any conflicts between footnote 6, second sentence and the aforementioned provision have to be resolved under the rules of treaty interpretation.

c. GATS Article XIV(e)

GATS Article XIV(e) may serve to exclusively justify violations of the MFN clause, contained in Article II, "provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound." [128] Currently, there is no jurisprudence on this provision. However, there are a number of peculiarities that should be pointed out.

First of all, the above referred to footnote 6 is not applicable in the context of Article XIV(e). Thus, measures "to prevent the avoidance or evasion of taxes"[129] are not explicitly covered by this provision. Furthermore, even where these measures fall within the ambit of a DTA one may wonder if the defense with regard to MFN treatment of Article XIV(e) extends to measures that do not relate to the avoidance of double taxation.

The ordinary meaning appears to be clear in so far that any DTA provision is covered. However, as directed by the VCLT, the terms need to be read in context and in light of the object and purpose of the treaty.[130] Immediate context is provided by the second part of the sentence beginning with 'provisions on the avoidance of double taxation'. It is unclear why a non-discrimination provision of

[126] GATS, Article XIV(d), footnote 6, second sentence.
[127] GATS Article XXVIII(o).
[128] GATS, Article XIV(e).
[129] GATS, Article XIV(d), footnote 6, paragraph iii.
[130] VCLT, Article 31(1).

a DTA is covered but a non-discrimination provision of, for example, another agreement that additionally provides for the avoidance on double taxation is not. In the case of the latter agreement only those provisions specifically related to double taxation are exempted. Furthermore, the object and purpose is to discipline discriminatory practices while providing a certain degree of regulatory freedom with respect to tax treaties by means of the exemption. If one were to read the exceptions too broadly, the object and purpose of the provision and the GATS more generally could be defeated.

Thus, it is proposed that an inquiry into the nature of the agreement is necessary. The mere fact that an agreement carries the words 'avoidance of double taxation' in its title is insufficient. Instead, a panel or the AB should ascertain if the agreement constitutes in fact an 'agreement on the avoidance of double taxation' as opposed to 'another international agreement or arrangement' that contains provisions on the avoidance of double taxation. It is advocated that agreements whose provisions go beyond the mere avoidance of double taxation and also seek to tackle double non-taxation, exchange of information or mutual administrative assistance constitute 'other international agreements or arrangements' and only those provisions directly related to the avoidance of double taxation are covered by GATS Article XIV(e). To find otherwise, would allow WTO members to undermine the MFN discipline imposed by Article II merely by inserting the words 'avoidance of double taxation' into the title of an agreement.

Non-discrimination provisions, for example, are not ensuring the avoidance of double taxation but provide for formally equal treatment in specific instances.[131] Furthermore, they serve the aim of protecting the tax base of the treaty partner where a tax credit is granted. Without such provisions a low-rate source state could impose discriminatory taxation up to the creditable amount without disadvantaging foreign or domestic producers and effectively soak up the tax base of the treaty partner.[132] Nevertheless, their widespread inclusion may justify the opinion that they form an integral part of DTAs.

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[131] See OECD Model Tax Convention, Article 24.
[132] AC Warren Jr, 'Income Tax Discrimination Against International Commerce' [2002] 54 Tax Law Review 131, p. 160.

Tax sparing provisions, however, are a somewhat more complicated example where it is unclear if they are covered by Article XIV(e). Generally, these provisions serve to protect the advantage resulting from tax holidays granted to attract foreign direct investment and are by no means ensuring the avoidance of double taxation. It seems illogical to argue that these provisions, when directly contained in a DTA, would be excluded. Where, however, they are subject of a later agreement not related to the avoidance of double taxation they could not be justified. If the later agreement, however, were concluded by means of a protocol that forms an integral part of a DTA, the tax sparing provisions would again fall under the exemption.

In light of these inconsistencies, it is proposed that the context as well as object and purpose of the provision require a direct assessment of the nature of an agreement. Under a restrictive approach only very few agreements are purely for the avoidance of double taxation and the majority of DTAs in fact constitute 'other agreements or arrangements' that contain provisions on the avoidance of double taxation. Measures that are genuinely taken for the avoidance of double taxation will, thus, fall under the exception whereas measures that in fact grant an unrelated advantage could be understood not to be the result of 'provisions on the avoidance of double taxation in any other international agreement or arrangement' regardless of how a Member characterizes the agreement. The purpose of the MFN obligation in conjunction with the exemption points to such an objective assessment of the nature of the agreement, which prevents a blanket exemption for all measures, contained in an agreement that merely purports to avoid double taxation.

d. The chapeau of Article XIV

The chapeau of Article XIV is worded similarly to its counterpart in the GATT. It imposes two requirements; that a measure may not "constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail" and may not constitute "a disguised restriction on trade in services".[133] Much has been written on the chapeau of GATS Article XIV and

[133] GATS, Article XIV.

GATT XX and this is not the place to repeat or elaborate on these findings.[134] However, it appears that earlier scholarship in the field of income taxation has somewhat underestimated the difficulty with which the standard established by the chapeau is met. If prior disputes under the GATT and GATS are any indication, it should be noted that the chapeau establishes a stringent standard that has been met once in the history of the WTO.[135] This is not to say that the WTO dispute settlement system is biased in favor of complainants. Rather, governments should be aware of the difficulty to justify a measure under GATT Article XX or GATS Article XIV once a violation of the respective agreement has been established. The mere presence of an exception clause for income tax measures certainly does not constitute a license to discriminate. To illustrate the hurdle that the chapeau may pose in the context of income tax measures, the recent *Argentina-Financial Services* dispute may serve as an example. Argentina did not encounter much difficulty in establishing that its measure is provisionally justified under subparagraph (c). However, when it came to the chapeau the Panel was less permissive. The Panel scrutinized the distinction made by the Argentinian measure between cooperative and non-cooperative countries. Countries with which Argentina concluded an agreement on exchange of information and those with which it had initiated negotiations with a view to concluding such an agreement were designated as cooperative. However, in reality even countries that did not engage in negotiations, such as Panama, were considered cooperative whereas others that in fact were negotiating with Argentina were not granted cooperative country status.[136] Furthermore, the objective of the Argentinian measure, to have access to information to combat harmful tax practices and money laundering is not achieved with respect to countries where no exchange of information occurs. Nevertheless, some were designated as cooperative countries. Relying on the AB's findings in the GATT case *Brazil-Tyres*, the Panel concluded "the absence of a relationship between the measures and the objectives indicates that the measures discriminate in an

[134] See for a general introduction, T Cottier and others, 'Article XIV GATS: General Exceptions' in R Wolfrum and others (eds) *Max Planck Commentaries on World Trade Law, Volume 6, WTO-Trade in Services* (Nijhoff 2008).
[135] ABR, *US-Shrimp (Article 21.5)*, WT/DS58/AB/RW, adopted 21 November 2001*)*, para 153.
[136] Panel Report, *Argentina-Financial Services*, para 7.756.

'arbitrary or unjustifiable' way."[137] Thus, prior jurisprudence seems to indicate that Panels and the AB adopt a lenient approach to the standard under the subparagraph but are far more stringent when reviewing compliance with the chapeau. Viewed from a different perspective, one could also state that countries appear to often pursue justifiable objectives. They are somewhat careless, however, in how they attempt to attain these objectives.

C. Income tax in the SCM Agreement

i. Applicability of SCM Agreement to Income Tax Subsidies

The Agreement on Subsidies and Countervailing Measures (SCM Agreement) imposes *inter alia* discipline on the granting of subsidies related to the trade of goods. For services there are currently no rules on the granting of subsidies but only a commitment to enter into negotiations to develop a subsidies code.[138] Under the SCM Agreement a subsidy is defined as a financial contribution that confers a benefit.[139] Prohibited subsidies are those that are contingent, in law or in fact, on export performance or contain a domestic content requirement.[140] Furthermore, any subsidy that is specific in the sense of Article 2 is actionable where it causes adverse affects to the interests of another member.[141] Next to prohibited and actionable subsidies a third category of exempted subsidies existed at the time of entry into force of the SCM Agreement. However, according to Article 31 of the SCM Agreement this category expired by the end of 1999 since no consensus as to its prolongation was reached.

Article 1.1, the definition of a subsidy, is a highly litigated provision, especially the question as to the existence of a benefit. For the purposes of this paper, however, it is more important to note that income tax incentives are generally covered by Article 1.1(a)(1)(ii), which refers to "government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)".[142] It is important here to bear in mind the distinction between

[137] Ibid, para 7.761.
[138] GATS, Article XV.
[139] Agreement on Subsidies and Countervailing Measures (SCM Agreement), 1869 UNTS 14, Article 1.1.
[140] SCM Agreement, Article 3.
[141] SCM Agreement, Article 5.
[142] SCM Agreement, Article 1.1(a)(1)(ii).

direct and indirect taxes. Rebates of indirect taxes upon export, meaning those levied on goods such as a Value-Added Tax, do not constitute a prohibited subsidy.[143] This becomes particularly clear when one considers the illustrative list of export subsidies contained in Annex 1, which provides examples of such subsidies including in paragraph (e) "[t]he full or partial exemption remission, or deferral specifically related to exports, of *direct taxes* or social welfare charges paid or payable by industrial or commercial enterprises."[144] Furthermore, this provision contains an important footnote 59 that amongst others establishes that transfer prices between related entities need to be those that would have existed if the enterprises had acted at arm's length and generally provides that paragraph (e) is not intended "to limit members from taking measures to avoid double taxation of foreign-source income".[145] Concerning the definition of income tax subsidies at times it may be difficult to establish a benchmark for revenue foregone.[146] Members may reclassify a tax exemption as the general rule and argue that no revenue is foregone.[147]

Since the SCM Agreement only relates to trade in goods, not every tax haven may find challenge under its provisions. Most promisingly, the Agreement potentially regulates what has been termed production tax havens.[148] The possibility to impose discipline on advance pricing agreements (APAs) between tax administrations and producers of goods that rubber stamp non-arm's length transfer prices and, thus, allow for profit shifting and tax avoidance is further explored in the next section. Subsequently, some light will be shed on the question of the interpretation of arm's length in the SCM Agreement.

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[143] SCM Agreement, footnote 1 to Article 1.1(a)(1)(ii).
[144] SCM Agreement Annex 1(e) [footnotes omitted] [emphasis by author].
[145] SCM Agreement Annex 1, footnote 59.
[146] AO Sykes, 'The Limited Economic Case for Subsidies Regulation' (2015) E15Initiative ICTSD <http://e15initiative.org/wp-content/uploads/2015/09/E15-Subsidies-Sykes-FINAL.pdf> accessed 7 June 2016, p. 5.
[147] In parts this is what the US attempted to do in the Extraterritorial Income Act that was enacted subsequently to the unfavorable findings in the first *US – FSC* Report.
[148] RS Avi-Yonah, 'Treating Tax Issues Through Trade Regimes' [2001] 26 Brooklyn Journal of International Law 1683, p. 1686; where the author distinguishes between production tax havens intended to attract production facilities, traditional tax havens that seek to attract foreign investors or service providers through minimal or no income taxes, and headquarter tax havens that promise to refrain from taxing income derived from foreign subsidiaries.

ii. Improper Transfer Pricing as Subsidy – the Case of Advance Pricing Agreements

As stated above, 'the full or partial exemption remission, or deferral specifically related to exports of direct taxes' constitutes a prohibited export subsidy. Footnote 59 to this provision affirms that the prices for goods charged by related entities need to be those that would have existed if both had acted at arm's length. Where a company charges too low a price to a related entity, it effectively shifts profits out of the country when exporting these goods. Similarly, where an importing company pays inflated prices to a related entity it lowers its tax base when importing the goods. In both cases, the income tax burden of the exporting or importing enterprise respectively is lowered since the mispricing erodes the domestic tax base. Thus, in both situations the company is not taxed sufficiently and the state foregoes revenue in the sense of 1.1(a)(1)(ii). This can be contrasted with the current trend in international taxation that seeks to battle exactly this type of base erosion and profit shifting. Hence, it will be explored to what extent the SCM Agreement may support efforts that tackle harmful tax competition. More specifically, the focus will be on the possibility to challenge APAs under the SCM Agreement. Particularly, where an APA approves a transfer price that is not in accordance with the requirements of arm's length as required by footnote 59.

Recently a number of cases involving APAs found challenge under the state aid procedures of the European Union (EU). These finding, however, cannot be transposed directly into the SCM context. The EU rules are in so far different that aid that distorts or threatens to distort competition and affects trade between Member States is prohibited unless it falls within the scope of one of the exceptions.[149] Since the former two criteria are inextricably linked, they are read in conjunction[150] and the European Court of Justice does not require an analysis thereof.[151] Thus, an effect on trade is generally presumed to exist. This is comparable to the situation of export subsidies or those connected to domestic

[149] Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326/47, Article 107(1) spells out the general rule, the exceptions are set out in Article 107(2).
[150] C Micheau, *State Aid, Subsidy and Tax Incentives under EU and WTO Law* (Kluwer Law International 2014), pp. 206f.
[151] ECJ, C-66/02 *Italian Republic v Commission of the European Communities* (Judgment, 15 December 2005), para 111.

content requirements in WTO law. Both are prohibited by the SCM Agreement without the showing of an effect on trade or competitive opportunities.

Export subsidies under the SCM Agreement require, however, contingency, in law or in fact, upon export performance.[152] Where a company in State A exports goods and undercharges a related entity in State B it shifts profits to B. In case the competent authority in State A approves such practice by means of an APA, it is possible to find export contingency. Without actually exporting the goods, company A cannot shift its profits to B as the subsidy logically requires the foreign purchase of the goods in question. Thus, the conditions of revenue foregone and export contingency are met. If a benefit is conferred largely depends on the income tax conditions in B. If the shifting of profits does not result in income tax savings, arguably a benefit is not conferred. However, it is doubtful that a company would engage in such practice if it were not able to actually save taxes. Hence, in this scenario one can find a prohibited export subsidy.

If the transfer mispricing occurs with respect to imported inputs, however, export contingency is not as easily established. In this scenario profits are shifted abroad by paying an inflated price when importing products from a foreign related entity. This lowers the tax base and, hence, tax burden of the importing company. Where the inputs are imported at inflated prices, processed and exported again it would have to be proven that the APA, legally or in fact, tied the subsidy to the anticipated exports of the final products.[153] According to footnote 4 of the SCM Agreement "[t]he mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy".[154] Prior case law provides some suggestions on how to establish export contingency. The awareness that a Member's "domestic market is too small to absorb domestic production of a subsidised product may indicate that the subsidy is granted on the condition that it be exported."[155] Equally, the ratio

[152] SCM Agreement, Article 3.1(a).
[153] Ibid; See also ABR, *Canada – Autos*, para 107 which noted "that a 'tie', amounting to the relationship of contingency, between the granting of the subsidy and actual or anticipated exportation" is required.
[154] SCM Agreement, footnote 4.
[155] Panel Report, *Canada-Aircraft Credits and Guarantees*, WT/DS222/R, adopted 19 February 2002, para 7.372.

of anticipated exports to domestic consumption in presence of the subsidy may be compared to the situation in absence of the subsidy to establish export contingency.[156] Ultimately, "[t]he existence of *de facto* export contingency, as set out above, 'must be inferred from the total configuration of the facts constituting and surrounding the granting of the subsidy'".[157] Therefore, it is difficult to make general statements if a subsidy is *de facto* contingent on anticipated export performance.

The recent State Aid case of alleged aid by The Netherlands to Starbucks illustrates the situation of inflated prices for imports.[158] The Amsterdam-based Starbucks Manufacturing BV is, among others, in the business of roasting green coffee beans that are subsequently sold in the European Market. The Amsterdam Company purchases these green coffee beans that are processed in the Netherlands from a Swiss-based Starbucks subsidiary. Allegedly inflated prices were paid to the Swiss subsidiary that in turn purchased green coffee beans on the world market. Profits for which Dutch income taxes would have been due were, hence, allegedly shifted from the Netherlands to Switzerland by means of the non-arm's length transfer price. The Dutch authorities and the Amsterdam-based subsidiary earlier concluded an APA that approved this non-arm's length practice. The difficulty with regard to WTO law arises as the APA did not require export performance. Theoretically, all the green beans that were roasted in the Netherlands could have been sold domestically and Starbucks could have still benefited from the subsidy. From the facts it is clear, however, that exports occurred since Starbucks Manufacturing BV is the only non-US based coffee-roasting facility within the Starbucks universe. One could seek to establish evidence that the ratio of anticipated export sales to domestic sales changed compared to the situation that would have persisted without the granting of the subsidy. As EU state aid law does not require export contingency, the proceedings by the EU Commission do not reveal the required market data. Hence, it is difficult to find export contingency without further investigation.

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[156] ABR, *EC and certain member States-Large Civil Aircraft*, WT/DS316/AB/R, adopted 1 June 2011, para 1047.
[157] Ibid, para 1046 (footnotes omitted).
[158] European Commission, *Netherlands-Alleged aid to Starbucks*, C(2014)/3626final (11 June 2014).

Alternatively, it is possible to argue that the APA grants an actionable subsidy. It appears that the requirement of specificity does not pose a hurdle. In fact, staying with the above example of alleged aid by the Netherlands to Starbucks, the Dutch Starbucks subsidiary was the only company whose income taxes were governed by the APA in question and no other enterprise could have requested the tax authorities to approve an improper transfer pricing methodology under the relevant rules. Thus, access to the subsidy was clearly limited to one company. Running the risk of being overly simplistic, it can be said that the question of adverse effects is largely factual in nature.

The element of revenue foregone is not as easily established as in the context of export subsidies. Footnote 59, requiring arm's length transfer prices, refers to item (e) in Annex 1 which deals with export subsidies only. Thus, the argument that arm's length transfer prices are not required in the context of actionable subsidies is not without merit. As the Netherlands normally impose such arm's length prices, however, in the specific circumstances of this case it is not difficult to establish the existence of a subsidy. Dutch tax legislation as well as virtually all Double Taxation Agreements entered into by the Netherlands require arm's length transfer prices between related entities. The benchmark for comparison is what the state normally imposes in terms of income tax. With respect to transfer prices one does not challenge the income tax rate but rather the calculation of the tax base, which ultimately determines the amount of tax due. The benchmark, thus, would be the usual manner in which the tax base is calculated. The APA in question diverged from this standard.

One could alternatively argue that observance of the principle of arm's length is generally required in the context of income tax subsidies. Thus, not only in situations where domestic legislation incorporates this standard or export subsidies are being challenged. Arm's length would then constitute the relevant benchmark in case of any actionable subsidy regardless of the fact that domestic legislation does not incorporate it. This would objectivize the standard of 'revenue foregone' with respect to transfer price disputes and arguably contradict earlier findings in which the Appellate Body consistently held that the benchmark for revenue foregone needs to be determined with reference to a Member's domestic "tax treatment of comparable income of comparably situated

taxpayers."[159] However, arguably these disputes dealt with issues where no objective international standard such as the principle of arm's length exists. Furthermore, the logic of the SCM Agreement appears to support the finding that arm's length transfer prices are generally required regardless of a Member's domestic tax treatment.

The Appellate Body dealt in *US-FSC* with the US attempt to argue that footnote 59 qualifies the definition of a subsidy under Article 1 of the SCM Agreement. The AB rejected this claim and restricted the applicability of footnote 59 to item (e) in Annex 1.[160] The US, however, argued in favor of restricting the definition of a subsidy. The argument here is rather that footnote 59 may provide relevant context in establishing the meaning of the term 'revenue foregone'. Footnote 59 expressly 'reaffirms' the principle of arm's length transfer prices between related entities. It does not impose or establish the principle but confirms its continuing validity. The relevant provision, Article 1.1(a)(1)(ii), could, hence, be interpreted to incorporate a requirement of arm's length transfer prices and footnote 59 merely constitute a clarification whose existence can be explained by historical reasons. Furthermore, Annex 1 constitutes an *illustrative* list and specifically item (e) seems to be based on Article 1.1(a)(1)(ii). Where a tax administration allows multinationals to shift profits outside its tax jurisdiction by approving non-arm's length transfer prices it, thus, arguably foregoes revenue even where this appears to be the rule rather than exception. Therefore, it is conceivable that a Panel finds an actionable subsidy where a transfer pricing methodology in an APA deliberately disregards the principle of arm's length.

iii. The Interpretation of Arm's Length in the SCM Agreement

The requirement in footnote 59 to set transfer prices at arm's length appears to be strict in the sense that non-arm's length transfer prices will be in breach of footnote 59 and lead to the finding of a prohibited export subsidy. The fundamental question as to the meaning of 'arm's length', however, is not addressed by the SCM agreement. Guidance may be found in the OECD Transfer

[159] ABR, *US-Large Civil Aircraft (2nd Complaint)*, WT/DS353/AB/R, adopted 23 March 2012, para 813.
[160] ABR, *US-FSC*, WT/DS108/AB/R, adopted 20 March 2000, paras 93-95.

Pricing Guidelines, which are considered "a basic tool for the application of the arm's length principle."[161]

From a substantive point of view the Guidelines are the necessary consequence of the separate entity approach explained above. To prevent improper transfer prices the OECD members have adopted the guidelines that establish methodologies for determining the arm's length price that would have been charged in the absence of the special conditions existing between related entities.[162] From a legal point of view, the guidelines were first approved by the OECD Committee on Fiscal Affairs and were subsequently adopted by the OECD Council as a Recommendation.[163] This recommendation is based on Article 5(b) of the OECD Convention and, hence, not legally binding on the international plane.[164] The following discussion, therefore, seeks to determine the extent to which outside materials, specifically non-binding guidelines promulgated by an organization with limited membership may be considered in WTO dispute settlement under the SCM Agreement.

In the context of other agreements that explicitly deal with non-binding standards there is guidance as to the manner in which these need to be adopted. [165] The procedural requirements are stringent as international standards may limit the WTO members' policy space in significant ways. The OECD Guidelines, however, deal with the rather technical question of ensuring proper transfer prices between related entities. It appears inappropriate to simply import what has been developed in the specific context of, for example,

[161] A Vega, 'International Governance through Soft Law: The Case of the OECD Transfer Pricing Guidelines' (2012) Max Planck Institute for Tax Law and Public Finance Working Paper 2012-05 <http://dx.doi.org/10.2139/ssrn.2100341> accessed 7 July 2016, p. 19.
[162] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Publishing 2010), p. 18.
[163] OECD, Recommendation of the Council on the Determination of Transfer Pricing between Associated Enterprises, C(95)126/FINAL (13 July 1995).
[164] Convention on the Organisation for Economic Co-operation and Development (adopted 14 December 1960, entered into force 30 September 1961), Article 5(c).
[165] See, for example, the Decision Of The Committee On Principles For The Development Of International Standards, Guides And Recommendations With Relation To Articles 2, 5 And Annex 3 Of The Agreement, November 2000, G/TBT/1/Rev.9 (TBT Committee Decision); it was later found in ABR, *US-Tuna II (Mexico)*, WT/DS381/AB/R, adopted 13 June 2012, para 372 that the decision constitutes a subsequent agreement in the sense of the VCLT Article 31(3)(a).

the TBT Agreement.[166] Therefore, in the absence of specific guidance, a different approach has to be taken.

Many have tackled the difficult question of the application of outside law within the confines of WTO dispute settlement. Even for instruments that carry the appearance of being non-binding, there may at times be room for a tribunal to, nevertheless, ascribe them some legally binding character.[167] Here, however, the vast majority of WTO members do not partake in OECD discussions and have not formally adopted the guidelines. The question is not one of applying binding outside rules but rather the manner in which a panel or the AB may use non-binding guidelines promulgated outside the context of the WTO. Most promising, therefore, is an approach that reduces the issue to one of treaty interpretation. There are a number of ways in which the guidelines may come before a panel or the AB; first, in the construction of the ordinary meaning of 'arm's length'; second, the OECD guidelines may constitute a subsequent agreement in the sense of VCLT Article 31(3)(a); third, the Guidelines could serve as evidence of subsequent practice under Article 31(3)(b); fourth, one could incorporate them by means of Article 31(3)(c), by arguing they constitute a relevant rule of international law applicable in the relations between the parties; or fifth, 'arm's length' may be regarded as a term with special meaning on the sense of VCLT Article 31(4).

According to the OECD MTC Commentary on Article 9, the provision that deals with transfer pricing between related enterprises, the OECD Guidelines represent "internationally agreed principles and provide guidelines for the application of the arm's length principle".[168] The AB in *US-FSC (Article 21.5)* found "[i]n seeking to give meaning to … footnote 59 …, which is a tax-related provision in an international trade treaty, we believe that it is appropriate for us

[166] If one were to do so, the OECD guidelines would without doubt fail to meet the requirements as to the organization's openness as established in Paragraphs 6 and 7 of the TBT Committee decision.

[167] See generally J Klabbers, 'International Courts and Informal International Law' in J Pauwelyn and others (eds), *Informal International Law Making* (OUP 2012) who finds that the presumptive law thesis sways courts to find a state's commitment to be bound where this may appear questionable at first sight.

[168] OECD Model Tax Convention, Commentary to Article 9, para 1; In the commentary to the UN Department of Economic and Social Affairs, United Nations Model Tax Convention between Developed and Developing Countries 2011 (UN Model Tax Convention) (United Nations 2012), p. 170 it is stated that the former group of experts in 1999 came to the same view as the OECD MTC, the current group of experts, however, did not fully consider this view yet.

to derive assistance from these widely recognized principles which many States generally apply in the field of taxation."[169] Interestingly, although the parties heavily relied on the OECD Guidelines in the original *US-FSC* dispute, which at the time were recently introduced, neither the Panel nor the AB explicitly referred to them.

With regard to the ordinary meaning of 'arm's length' the Oxford Dictionary's definition is of little help providing that it refers to, "away from close contact or familiarity, at a distance".[170] However, following the Panel's approach in *China – Electronic Payment Services* arguably it is possible to go beyond the dictionary definition of a term to establish its ordinary meaning.[171] The concerns that the transfer pricing guidelines reflect the self-interest of certain actors should be much smaller than they are in the case of industry sources as in the aforementioned dispute.[172] Based on the current widespread acceptance of the OECD Guidelines and the Panel's practice in *China – Electronic Payment Services*, it appears conceivable that a Panel relies on the Guidelines in constructing the ordinary meaning of the term 'arm's length'.

Second, it could be argued that the OECD Guidelines constitute a subsequent agreement in the sense of VCLT Article 31(3)(a). The AB noted that the term 'agreement' "refers, fundamentally, to substance rather than form."[173] Thus, the fact that the OECD Guidelines are not internationally binding as such does not necessarily constitute a hurdle. However, it is required that the Guidelines "express an agreement between Members on the interpretation or application of a provision of WTO law."[174] The OECD Guidelines do not once mention the WTO or the SCM Agreement. Thus, they arguably do not directly constitute an agreement on the interpretation of a provision of WTO law. In light of the absence of any direct link to the WTO, it appears unlikely that a Panel will

[169] ABR, *US – FSC (Article 21.5),* para 142.
[170] *The Oxford English Dictionary* (OUP 1978) Volume I, p. 448.
[171] Panel Report, *China-Electronic Payment Services*, WT/DS413/R, adopted 31 August 2012, para 7.89 finds "no reason why a panel's search for the ordinary meaning of any term should always be confined to regular dictionaries."
[172] Ibid.
[173] ABR, *US-Clove Cigarettes*, para 267.
[174] Ibid, para 262; the statement was made with respect to a ministerial decision. There is no reason, however, that one could assume the AB would adopt a more lenient approach to materials originating outside the WTO, rather the opposite appears likely.

consider the Guidelines a 'subsequent agreement on the interpretation' of footnote 59 of the SCM Agreement.

Third, with respect to subsequent practice under Article 31(3)(b), it is possible to argue that although the Guidelines emanate from the OECD, they are widely applied in the tax treaty practice as well as domestic courts of the WTO members.[175] However, there are also instances where domestic courts explicitly reject the Guidelines. The US argued in *US-FSC*, if the Panel were "to declare the OECD Guidelines as the applicable benchmark for measuring compliance with the arm's length principle of footnote 59, it would be imposing OECD norms on the 100-plus WTO Members that have not acceded to those Guidelines"[176] The main problem with establishing that the existing practice is relevant to the interpretation of the SCM Agreement is that it occurred outside the WTO. The provision requires subsequent practice in the application of the treaty and currently it is difficult to argue that such practice or acceptance thereof is discernible.

Fourth, with respect to the OECD Guidelines constituting a relevant rule of international law applicable in the relation between the parties under Article 31(3)(c). First, there is the obvious problem that non-binding guidelines may arguably not constitute a rule of international law. However, arguments have been presented that even if a guideline "is not legally binding, it may reflect the agreement or broad consensus of the parties, international community, or other relevant community on a particular issue, an agreement… which may be referred to… in the interpretation of a treaty which is legally binding".[177] An additional problem is posed by the fact that current jurisprudence requires the rule to be binding on all 162 WTO Members.[178] There is the remote possibility that in fact all members in one way or another adopted the OECD Guidelines, either formally or by reference in their DTAs. However, overall in light of these difficulties one

[175] See Vega, supra 155, pp. 19ff for examples of practice in national legislation and court decisions.
[176] Panel Report, *US-FSC*, WT/DS108/R, adopted 20 March 2000, para 4.392.
[177] J Pauwelyn, 'Is It International Law or Not, and Does It Even Matter?' in J Pauwelyn and others (eds), *Informal International Law Making* (OUP 2012), p. 156 [footnotes omitted].
[178] Panel Report, *EC-Approval and Marketing of Biotech Products*, WT/DS291/R, adopted 21 November 2006, para 7.70 continues to constitute relevant precedent in light of the fact that the ABR, *Peru-Agricultural Products*, WT/DS457/AB/R, adopted 31 July 2015, para 5.105 did not express a view on the matter.

may doubt that a Panel would rely on Article 31(3)(c) to utilize the OECD Guidelines.

Lastly, with regard to the argument that arm's length in footnote 59 is a term with special meaning in the sense of VCLT Art. 31(4) difficulties arise. After the problems in adopting the *US – DISC* and related GATT Panel reports an understanding was adopted in 1981 that already referred to the observance of arm's length transfer prices.[179] Although the Panel and the AB found the Understanding not to be legally binding on WTO members generally,[180] it provides unmistakable evidence of the awareness of the issue of non-arm's length transfer prices long before the OECD Guidelines were promulgated in 1995. Even during the negotiations and before entry into force of the SCM Agreement the Guidelines were not in existence. Thus, it seems difficult to maintain that 'arm's length' is a special term as defined by the transfer pricing guidelines.

In light of the above one is compelled to conclude that an argument as to the applicability of the OECD Guidelines in the context of the WTO Agreement is difficult to defend. However, one cannot ignore the numerous instances in which Panels and the AB made reference to OECD materials. In *Brazil-Aircraft*, for example, the AB explicitly relied on the OECD Arrangement on Guidelines for Officially Supported Export Credits and essentially assessed Brazil's compliance with the SCM Agreement on basis of the OECD Arrangement.[181] Similarly the Panel in *Argentina-Financial Services* extensively referred to the OECD and G20 defensive measures in assessing Argentina's defense under GATS Article XIV.[182] This is not the place to conceptualize the Panels' and AB's approach to non-binding guidelines but it appears that they are simply regarded as facts where it suits the Panel. One would, thus, not be surprised if a Panel simply stated that the OECD Guidelines provide useful guidance to assess a Member's conformity with the arm's length principle, without disclosing on what basis this is done. Therefore, it can be concluded that a Member will encounter serious difficulties

[179] GATT Council, Tax Legislation, L/5271 (18 December 1981).
[180] Panel Report, *US-FSC*, para 7.89, ABR, *US-FSC*, para 120.
[181] ABR, *Brazil-Aircraft*, WT/DS46/AB/R, adopted 20 August 1999, para 181.
[182] See for example, Panel Report, *Argentina-Financial Services*, para 7.715.

in defending its compliance with footnote 59 where it contravenes the OECD Guidelines.

A last word in this context is necessary with respect to the recent proposed revision of the OECD Guidelines. The OECD Action Plan on Base Erosion and Profit Shifting (BEPS) foresaw the possibility to adopt transfer pricing rules or special measures beyond the arm's length principle.[183] If states were to adopt such measures their practices could potentially be challenged under the SCM Agreement. The output achieved in the BEPS package, however, finds that the goals of the Action Plan have been attained "without the need to develop special measures outside the arm's length principle."[184] One may question the accuracy of the statement in light of the proposed significant changes to the OECD Guidelines.[185] Instead of doing so, however, it would be more useful to establish who possesses the authority to interpret the meaning of arm's length. If the international community accepts the proposals in the BEPS package to constitute a proper interpretation of arm's length, it appears doubtful that a Panel or the AB would question this interpretation and develop its own standard. From a strictly legal point of view, however, there is nothing that would prevent the DSB from giving an independent meaning to the term.

Therefore, having established the potential reach of the GATT, GATS and SCM Agreement into the field of income tax policy, it is necessary to recognize that overlap between the respective dispute settlement mechanisms may occur. A state may decide to challenge a discriminatory income tax practice or the non-arm's length transfer prices of a treaty partner either in the WTO or, where applicable, under a DTA. The following section reviews how such overlaps may be mitigated.

[183] OECD, Action Plan on Base Erosion and Profit Shifting (OECD Publishing 2013), pp. 20f.
[184] BEPS Actions 8-10, supra 80, p. 12.
[185] To provide just one example in the context of financial services, BEPS Action 8-10, supra 80, p. 45ff where the strict separate entity approach is relaxed to allow for synergies arising as a result of passive association with a larger MNE group. Many may find this to constitute a deviation from the arm's length principle.

II. The Intersection of Tax Dispute Resolution and WTO Dispute Settlement

This second part analyses conflicts between the resolution of income tax disputes under DTAs and WTO dispute settlement. Whereas the first part established the far reach of substantive WTO rules, here rules of a procedural nature will be considered. A distinction is often drawn, between on the one hand, conflicts of law, or conflicts of substantive rules that consider clashes of conduct prescribing norms and, on the other hand, conflicts of jurisdictions.[186] The analysis of the latter tends to focus on overlapping *judicial* proceedings with the aim to highlight and prevent the risk of incompatible decisions.[187] The increasing spread of binding income tax arbitration may result in such parallel proceedings and incompatible decision. However, the approach taken here exceeds such narrowly defined overlaps.

International dispute settlement by diplomatic means does not exclusively occur where legal lacunas exist but may also be the result of disagreement over the application of existing legal norms. An alternative forum for the settlement of disputes is not only an alternative *judicial* forum that provides authoritative interpretations of ambiguous treaty language. It may also be a forum that successfully institutionalizes the diplomatic settlement of disputes, successful in quantitative terms of actually solving disputes and in a qualitative sense of delivering outcomes that are acceptable to both parties. The antilegalistic settlement of tax disputes, embodied in the Mutual Agreement Procedure (MAP) constitutes such a successful forum that institutionalizes diplomatic dispute resolution. This paper, thus, takes a wide approach to conflicting proceedings. This is done because conflicting judicial decisions are not by themselves problematic except for the parties. The underlying cause for concern is that both fora claim legitimacy on the international plane but their conflicting decisions threaten to undermine the perceived legitimacy of one

[186] PJ Kuijper, 'Conflicting Rules and Clashing Courts: The Case of Multilateral Environmental Agreements, Free Trade Agreements and the WTO' (2010) ICTSD Issue Paper No. 10 <http://www.ictsd.org/downloads/2011/12/conflicting-rules-and-clashing-courts.pdf> accessed 7 July 2016, p. 4.

[187] Y Shany, *The Competing Jurisdictions of International Courts and Tribunals* (OUP 2003), p. 23; in the WTO context see generally PA Lanyi and A Steinbach, 'Limiting Jurisdictional Fragmentation in International Trade Disputes' [2014] 5(2) Journal of International Dispute Settlement 372, p. 376.

another. Where the same income tax dispute is capable of being settled in the WTO or by the MAP with potential subsequent arbitration, the latters existence may well challenge the legitimacy of the DSB to usurp the dispute.

This approach is admittedly broad but warranted. The alternative of artificially excluding conflicts by means of defining their existence restrictively will prevent the discovery of underlying problems and possible solutions. Identity of cases in judicial proceedings in the sense of the same parties invoking the same law with regard to the same set of facts is technically impossible as the cause of action will always be different in tax and trade.[188] Rivalry between the dispute settlement mechanisms of tax and trade is likely to occur, however, in the sense that two regimes are applicable to a given set of facts and the question arises as to which regime is more appropriate, and can hence claim greater legitimacy for the settlement of the dispute in question.[189] In the following the jurisdictional overlap between tax and trade will be explored as well as the appropriateness of settling income disputes in the WTO. This part closes with a number of recommendations on how members may mitigate the problem of overlap from within and outside the WTO.

Before doing so, some context is provided by highlighting a number of situations in which both sets of rules, those of tax and trade are applicable. Although the instances of *de jure* discrimination to which Article 24 of the OECD Model Tax Convention applies are limited, it is immediately evident that an overlap between the non-discrimination provisions contained in the GATT and GATS as well as those in DTAs may occur. Where a state *de jure* discriminates against non-national residents[190] or permanent establishments[191] of a tax treaty partner the NT provision of the GATS may apply alongside the DTA. Similarly, where a transfer-pricing dispute arises and depending on the specific facts, the dispute could be framed as one of discrimination under the GATT or GATS or potentially as a dispute concerning subsidies under the SCM Agreement. In

[188] Kuijper, supra 180, p. 37; makes this observation in the context of FTAs and WTO law but the concerns are essentially the same when considering DTAs and WTO law.
[189] Michaels and J Pauwelyn, 'Conflict of Norms or Conflict of Laws?: Different Techniques in the Fragmentation of International Law' in T Broude and Y Shany (eds), *Multi-Sourced Equivalent Norms in International Law* (OUP 2011), p. 35ff termed this conflicts between branches of international law.
[190] OECD Model Tax Convention, Article 24(1).
[191] Ibid, Article 24(3).

addition, Articles 7 or 9 of the OECD MTC, dealing with transfer prices, are potentially applicable. Thus, it is evident that the substantive overlap of both sets of rules may lead to situations in which the dispute settlement fora of tax and trade rival one another.

A. Dispute Settlement in the Tax and Trade Regime – An Overview

Dispute settlement within the WTO generally follows the rules set out in the Dispute Settlement Understanding (DSU), with minor peculiarities pertaining to different agreements. Despite the international tax system's bilateral character, there is great similarity in the dispute settlement mechanisms under DTAs. Below the Mutual Agreement Procedure (MAP) and binding tax arbitration, existing under an increasing number of DTAs, is considered. Additionally, some background as to *locus standi* in the WTO will be provided.

i. The Mutual Agreement Procedure

The MAP is the predominant procedure to settle income tax disputes and virtually every DTA contains a provision to that effect. In the OECD MTC the pertinent provision can be found in Article 25 which states that in case of taxation not in accordance with the provisions of the DTA, the taxpayer may present his case to the competent authority of the state of which he is a resident or in case of a violation of the non-discrimination provision in Article 24(1) to that of which he is a national.[192] Additionally, a time limit of three years is imposed.[193] Where a competent authority considers the objection justified and cannot by itself arrive at a satisfactory solution it shall endeavor to resolve the case by mutual agreement with the competent authority of the other contracting state.[194] Furthermore, "[t]he competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention."[195] Thus, the procedure enables a taxpayer to alert a competent

[192] Ibid, Article 25(1).
[193] Ibid.
[194] Ibid, Article 25(2).
[195] Ibid, Article 25(3).

authority to a case of double taxation and in the second phase allows for a bilateral exchange between the treaty partners to resolve the issue. No obligation to reach an agreement, however, is imposed.

Under certain circumstances, competent authorities may deny access to the MAP. This may be the case where a treaty's anti-abuse provision is triggered,[196] where a serious violation of domestic law results in the imposition of significant penalties,[197] or where domestic constitutional law prevents a competent authority from initiating the MAP.[198] BEPS Action 14 generally recognized the problem that at times uncertainty as to the right of access to the MAP may arise and seeks to update the OECD MTC Commentary to provide more clarity as to the existence of such situations.[199]

Quantitatively a steady increase in the number of MAP cases that are being initiated can be observed. Whereas in 2006 a total of 1036 MAPs where initiated by the OECD members, this number rose to 2266 MAPs in 2014.[200] Similarly the number of pending cases at the end of 2014 more than doubled with 5423 cases compared to 2352 cases in 2006.[201] On average a MAP case took 23.79 months to complete in the 2014 reporting period.[202]

ii. Binding Income Tax Arbitration

A limited number of treaties provide for binding income tax arbitration.[203] Whereas the MAP is a relatively homogenous procedure across different income

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[196] OECD, *Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (OECD Publishing 2015), p. 14, para 13.
[197] OECD Model Tax Convention, Commentary to Article 25, para 26.
[198] OECD Model Tax Convention, Commentary to Article 25, para 27.
[199] BEPS Action 14, supra 190, p. 15, para 17.
[200] OECD, Mutual Agreement Procedure Statistics for 2014, <http://www.oecd.org/ctp/dispute/map-statistics-2014.htm> accessed 6 June 2016.
[201] Ibid.
[202] Ibid.
[203] See for example: Convention between the Kingdom of the Netherlands and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income (signed 25 August 2010, entry into force 29 December 2011), Article 24(5); Agreement between Australia and the Federal Republic of Germany for the Elimination of Double Taxation With Respect to Taxes on Income and Capital and the Prevention of Fiscal Evasion and Avoidance (signed 12 November 2015, pending entry into force), Article 25(5); other examples include the tax treaties between the US and Mexico, Article 26(5); 2015 Canada/UK Exchange of Notes on Arbitration (signed 11 August 2015, pending entry into force) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/512727/2015_CanadaUK_Exchange_of_Notes_on_Arbitration.pdf> accessed 6 June 2016; a full survey of all

tax treaties, income tax arbitration differs in so far that its successful implementation requires detailed regulation. Article 25(5) of the OECD MTC provides a model clause under which taxpayers may request the initiation of arbitral proceedings where they commenced a MAP under Article 25(1), taxation not in accordance with the Convention, and two years have lapsed since the MAP has been initiated. The commentary to Article 25 provides a sample agreement for the implementation of this provision.[204] The sample agreement covers in 20 Articles pertinent issues such as the request for arbitration, terms of reference, selection of arbitrators, time limits, applicable law, evidentiary rules, *et cetera*.

Additionally, the possibility exists to provide for income tax arbitration by means of a multilateral agreement such as the EU Transfer Pricing Arbitration Convention (AC).[205] The AC is limited to cases of adjustment of profits of associated enterprises and provides for a MAP similar to the one described above with subsequent arbitration where no agreement was reached within two years.[206] Its provisions are further implemented through a Code of Conduct developed by the Joint Transfer Pricing Forum in collaboration with competent authorities and other stakeholders.[207]

It is necessary to understand the income tax arbitration does not replace the MAP but constitutes an extension thereof "that serves to enhance the effectiveness of that procedure".[208] It is generally considered that arbitration "should make the mutual agreement procedure itself more effective even in cases where resort to arbitration is not necessary."[209] Interestingly, despite strict time limits an extremely low number of cases have been arbitrated under the AC.[210] Nevertheless, the AC is considered to improve the MAP as it provides an

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agreements exceeds the scope of this analysis but a trend towards more arbitration is discernible.

[204] OECD Model Tax Convention, Commentary to Art 25, pp. 381ff.

[205] Convention 90/436/EEC on the Elimination of Double Taxation in Connection With the Adjustment of Transfers of Profits Between Associated Undertakings [1990] OJ L225/10.

[206] EU AC, Article 6 MAP; and Article 7 arbitration.

[207] Revised Code of Conduct for the Effective Implementation of the Convention on the Elimination of Double Taxation in Connection With the Adjustment of Profits of Associated Enterprises [2009] C322/1.

[208] OECD Model Tax Convention, Commentary to Article 25, para 64.

[209] OECD Guidelines, supra 156, para 4.168.

[210] By July 2015 the Joint Transfer Pricing Forum that administers the EU AC has been notified of 5 arbitral awards since the EU AC's entry into force in 1995. To date no report was made public. This number seems low considering that a large count of cases exists for which the two-year time limit expired. The disregard for the strict time limit was commented on by some parties to the EU

additional incentive for states to find a mutually agreed solution. As one commentator puts it "the prospect of arbitration would serve to focus the minds of the administrative authorities to find a sensible solution, for fear of seeing the matter taken out of their hands altogether for decision by a neutral tribunal."[211]

Recently "a group of countries has committed to adopt and implement mandatory binding arbitration".[212] It is envisaged that a binding arbitration provision will be developed in the context of the multilateral agreement that modifies existing DTAs under BEPS Action 15.[213] Disagreement over pertinent issues such as the compensation of arbitrators, however, will continue to pose a serious obstacle to the multilateral implementation of income tax arbitration.[214]

iii. *Locus Standi* in the WTO – The Right of Access to WTO Dispute Settlement

The situation under WTO law is quite different. Articles 1(1) and 23(1) provide for the exclusive and compulsory jurisdiction of the WTO in case of a violation of the covered agreements.[215] Under DSU Article 3.7 "a Member shall exercise its judgement as to whether action under these procedures would be fruitful."[216] In *EC-Bananas III* the AB found that "a Member has broad discretion in deciding whether to bring a case against another Member under the DSU… [and] is expected to be largely self- regulating in deciding whether any such action would be 'fruitful'."[217] Furthermore, no legal interest is required to bring a claim.[218] It can generally be said that a WTO Member's choice to initiate dispute settlement

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AC by stating "[t]he conduct of particular mutual agreement procedures, including those undertaken under the Arbitration Convention, is a matter for the competent authorities involved." See EU Joint Transfer Pricing Forum, Update of the Follow-up on the Reentry into Force of the Arbitration Convention (2006) JTPF/009/BACK/REV2/2006/EN.

[211] WW Park, 'Income Tax Treaty Arbitration' [2001] 10 George Mason Law Review 803, p. 804.

[212] BEPS Action 14, supra 190, para 62.

[213] BEPS Action 14, supra 190, para 63.

[214] Under the 2015 Canada/UK Exchange of Notes, supra 197, for example, arbitrators are compensated according to ICSID rules. Under the EU Transfer Pricing Arbitration Convention arbitrators merely receive 1000 Euros *per meeting day* making it generally far less attractive to participate in such proceedings. Readers who are familiar with the modes of remuneration under ICSID can imagine that the costs of arbitral proceedings may quickly exceed the amount at stake in the tax dispute.

[215] For the purposes of this paper the issue of non-violation and situation complaints will be disregarded.

[216] DSU, Article 3.7.

[217] ABR, *EC-Bananas III*, para 135.

[218] Ibid, para 132.

proceedings largely escapes the scope of review by Panels or the AB. The lenient requirements as to standing are well illustrated by the *Argentina-Financial Services* dispute that dealt with a number of Argentinian income tax measures. Panama, the complainant, was initially considered an uncooperative jurisdiction by Argentina. However, by the time the Panel was established in the dispute Argentina included Panama in the list of cooperative countries.[219] Nevertheless, neither the Panel nor the AB decided that the case of alleged MFN and NT violations was moot. Instead the Panel explicitly states "the submission of claims under Article II:1 of the GATS does not require that the allegedly less favourable treatment that is the subject of the complaint must refer to the complaining party in this dispute".[220] Therefore, it can be said that even where a WTO member does not discriminate directly against a complaining party, the latter is not barred from instituting proceedings.

B. Challenging the Jurisdiction of the WTO DSB – Jurisdiction and Admissibility

As briefly alluded to above, DSU 1(1) and 23(1) provide for the exclusive and compulsory jurisdiction of the WTO with regard to any alleged violation of the covered agreements. However, having determined the scope of the jurisdiction of the DSB does not necessarily mean that any dispute falling within this scope is automatically subject to adjudication by a panel or the AB. In *Mexico – Soft Drinks* the Panel observed that it is not "in a position to choose freely whether or not to exercise its jurisdiction. Were a panel to choose not to exercise its jurisdiction in a particular case, it would be failing to perform its duties."[221] The AB did not find issue with this view but went on to clarify that it would "express no view as to whether there may be other circumstances in which legal impediments could exist that would preclude a panel from ruling on the merits of the claims that are before it."[222] Thus, it appears that the AB opened the door to allow for considerations that might ultimately lead a panel to decline the exercise of its own jurisdiction.

[219] ABR, *Argentina-Financial Services*, para 5.5.
[220] Panel Report, *Argentina-Financial Services*, para 7.196.
[221] Panel Report, *Mexico-Taxes on Soft Drinks*, WT/DS307/R, adopted 24 March 2006, para 7.8.
[222] ABR, *Mexico-Taxes on Soft Drinks*, para 54.

The Permanent Court of International Justice found in the *Mavrommatis Palestine Concessions* Case

> "… the preliminary question to be decided is not merely whether the nature and subject of the dispute laid before the Court are such that the Court derives from them jurisdiction to entertain it, but also whether the conditions upon which the exercise of this jurisdiction is dependent are fulfilled in the present case."[223]

These 'conditions' referred to by the PCIJ can be understood parallel to the 'legal impediments' mentioned by the AB. The concept that both adjudicative bodies seem to be alluding to is the issue of admissibility.

A fundamental distinction has to be drawn between, on the one hand, the jurisdiction of a court or tribunal and, on the other hand, the conditions of admissibility of a dispute. A tribunal's finding that it has jurisdiction does not necessarily compel it "in every case to exercise that jurisdiction."[224] There is, thus, a tripartite division of a case into jurisdiction, admissibility, and merits.[225] The former two phases are rarely considered in WTO dispute settlement. However, at times such objections are raised and it appears the AB generally accepts that a case may be inadmissible as the complainant relinquished its right to have recourse to WTO dispute settlement.[226] That a member relinquishes its right to dispute settlement cannot be understood, however, to mean that the panel is deprived of its jurisdiction to entertain the dispute. It merely means that there are 'legal impediments' to the exercise of such jurisdiction. The case is inadmissible.

An important difference between jurisdiction and admissibility is that the former is examined by the tribunal sua sponte,[227] whereas the latter needs to be

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[223] PCIJ, *The Mavrommatis Palestine Concessions (Greece v Great Britain)* (Jurisdiction) PCIJ Rep Series A No 2, p. 10.
[224] ICJ, *Case Concerning the Northern Cameroons (Cameroon v United Kingdom)* (Preliminary Objections) [1963] ICJ Rep 15, p. 29.
[225] ICJ, *Nottebohm Case (Liechtenstein v Guatemala)* (Preliminary Objections) [1953] ICJ Rep 111, p. 123.
[226] ABR, *EC-Bananas III*, para 217, see also more recently the ABR, *Peru-Agricultural Products*, paras 5.20-28 where Peru's arguments based on an FTA where ultimately rejected. Note, however, that the AB never adopted the terminology of admissibility.
[227] ABR, *Mexico-Corn Syrup (21.5)*, WT/DS132/AB/RW, adopted 21 November 2001, para 36 "[P]anels have to address and dispose of certain issues of a fundamental nature, even if the parties to the dispute remain silent on those issues. … Rather, panels must deal with such issues –

raised by the parties to the dispute.[228] This consequence appears logical considering that objections to the admissibility of a dispute may arise out of legal relations beyond the scope of the WTO covered agreements. In *Peru – Agricultural Products* the AB accepted that a member may relinquish its "right to initiate WTO dispute settlement proceedings in a form other than a waiver embodied in a mutually agreed solution".[229] Whereas a mutually agreed solution would be notified to the WTO DSB and should, thus, arguably be known to a subsequent panel, it is far less likely that a panel would be aware of the legal relations between the disputing parties outside the confines of the WTO, such as those contained in a Double Taxation Agreement.

The following section analyses grounds on which a Panel may find income tax disputes inadmissible under the GATT, GATS, and SCM Agreement.

C. Alleviating the Problem of Rivaling Proceedings

i. Competing Proceedings under GATT and Tax Treaties

Unlike GATS, GATT 1994 does not contain an explicit carve out for income tax measures.[230] As the drafters apparently were aware of the possibility to include a carve out, this omission must have been deliberate, especially in light of the fact that the *US – DISC* dispute clearly evidenced the applicability of the GATT to income tax measures albeit under Article XVI relating to subsidies.[231] Therefore, the basis on which a Panel could decline to rule on a GATT dispute needs to derive from rules beyond the four corners of the covered agreements.

Since both the GATT and DTAs constitute public international law treaties, VCLT Article 30 on successive treaties could potentially apply.[232] As no provision similar to NAFTA Article 2103(2) is to be found in the WTO agreement, it is necessary to rely on Article 30(4).[233] It provides for the situation in which

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if necessary, on their own motion – in order to satisfy themselves that they have authority to proceed."

[228] J Pauwelyn and LE Salles, ' Forum Shopping Before International Tribunals: (Real) Concerns, (Im)Possible Solutions' [2009] 42 Cornell International Law Journal 77, p. 96.

[229] ABR, *Peru-Agricultural Products*, para 5.25.

[230] GATS Article XXII(3), discussed below in section II.C.ii.

[231] GATT Panel Report, *United States-Income Tax Legislation.*

[232] The Article has been considered in ABR, *EC-Poultry*, WT/DS69/AB/R, adopted 23 July 1998, para 79.

[233] See VCLT Article 30(2); North American Free Trade Agreement (NAFTA) 32 ILM 289, Article 2103(2) subordinates NAFTA to any tax convention concluded by a member.

not all the parties to the earlier treaty are parties to the latter one and,[234] thus, appears to apply in the tax-trade context. An important limitation is imposed by the title of Article 30, namely that both treaties need to be on the same subject matter. It has been argued that in case of a conflict the same subject matter issue seems to be implicit.[235] However, an incidental overlap cannot be sufficient to fulfill the condition of relating to the same subject matter. The ILC's findings in the context of fragmentation of international law supports this by stating "in cases of conflicts or overlaps between treaties in different regimes, the question of which of them is later in time would not necessarily express any presumption of priority between them".[236] Relying on the VCLT's *travaux préparatoires* it has been found that both treaties need to be "of comparable levels of generality".[237] It appears difficult to argue that tax treaties and the GATT fulfill the requirements of Article 30. Therefore, the simultaneous applicability of tax treaties and the GATT cannot be excluded on basis of VCLT Article 30.

Another argument that has been brought forward is based on the legal concept of estoppel, which is considered to constitute a general principle of international law.[238] It has been "argued that most WTO Members have concluded tax treaties with each other and that this fact alone would estop them from taking action against their treaty partners for breach of GATT".[239] Estoppel has been raised in a number of cases before Panels and the AB but so far did not result in a successful challenge to WTO proceedings.[240] However, it is doubtful that the mere conclusion of a DTA is sufficient for a finding of estoppel with respect to the GATT. The legal concept requires an element of detrimental

[234] VCLT, Article 30(4).
[235] JE Farrell, 'The Effects of Global and Regional Trade Agreements on Domestic Tax Law and Bilateral Tax Conventions: Proceedings of a Seminar held at the 60th International Fiscal Association Congress' [2007] 35(4) Intertax 286, p. 292.
[236] M Koskenniemi, 'Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law' Report of the Study Group of the International Law Commission, UN Doc A/CN.4/L.682, para 26.
[237] M Lennard, 'Navigating by the Stars: Interpreting the WTO Agreements' [2002] 5(1) Journal of International Economic Law 17, p. 71.
[238] See generally, ML Wagner, 'Jurisdiction by Estoppel in the International Court of Justice' [1986] 74(5) California Law Review 1777, pp. 1777-1784 provides an insightful overview as to the concept's origins and content on the international plane.
[239] van Thiel, supra 69, p. 24.
[240] See, for example, Panel Report, *Argentina-Poultry Anti-Dumping Duties*, WT/DS241/R, adopted 19 May 2003, footnote 58 where Argentina argued that Brazil was barred from bringing the claim as it had lost the earlier MERCOSUR proceedings. The Panel refused to decide on the applicability of estoppel but instead found that its conditions, if applicable, would not be fulfilled.

reliance.[241] Thus, one would have to establish that a Member was aware of its breach of the GATT when concluding the DTA and the treaty partner, respondent in the WTO proceedings, relied on the first Member's assurances not to challenge an income tax measure under the GATT. It appears unlikely that this condition is met in practice.

In an earlier analysis it has been found that "[i]n the short- to medium-term, the best way to address forum shopping among international tribunals is to regulate overlaps explicitly in the relevant treaties. General principles of law will simply not do."[242] As much as it is desirable and could contribute to predictability in the legal relations between the WTO members, in light of recent jurisprudence it seems possible that a Panel will not defer to explicitly regulated overlaps where this was done in an outside agreement. A treaty conferring exclusive jurisdiction to another tribunal, for example, would under a restrictive view not necessarily bar WTO Panels from exercising their jurisdiction. In *Peru-Agricultural Products*, the AB stated that Members may not "relinquish their rights and obligations under the DSU beyond the settlement of specific disputes."[243] A 'specific dispute', one could argue, does not arise in the abstract. Thus, a restrictive view on outside law in the WTO would advocate that Members must relinquish their right to WTO dispute settlement after the dispute arises. To somewhat soften this restrictive view it is proposed that a limited opportunity for outside treaties to influence the question of admissibility remains. A provision granting exclusive jurisdiction to the dispute settlement mechanism in a DTA or a fork-in-the-road provision, which is essentially an exclusive jurisdiction clause once a dispute has been initiated, could lead a WTO panel to find a dispute inadmissible. This is only possible, however, with respect to disputes that have been or are currently settled in the other forum. In these circumstances, in line with *Peru – Agricultural Products* it could be argued that the member only relinquished its right with respect to that one specific dispute. Although the facts provided for the possibility, this argument was not tested in

[241] Panel Report, *Guatemala-Cement II*, para 8.23.
[242] Pauwelyn and Salles, supra 222, p. 117.
[243] ABR, *Peru – Agricultural Products*, footnote 106.

Mexico – Soft Drinks with respect to exclusive jurisdiction clauses in FTAs.[244] A broader, and more desirable approach to questions of admissibility that is in line with the AB's statement would be to advocate that Members could *ex facto* agree on a specific set of disputes that is excluded from WTO dispute settlement,[245] such as those falling within the scope of a DTA. Where states explicitly deprive the DSB of its power to adjudicate a set of disputes, panels should respect such clauses to the extent that third party rights remain unaffected. Therefore, it appears generally to be possible that a Panel would refrain from exercising its jurisdiction provided the necessary conditions are met.

ii. Overlapping Proceedings and the GATS

The GATS provides explicit guidance on the interaction of tax and trade matters in its Article XXII(3). Due to its centrality, it is worth repeating the complete provision here.

> "A Member may not invoke Article XVII [the national treatment provision], either under this Article or Article XXIII [Dispute Settlement and Enforcement], with respect to a measure of another Member that falls within the scope of an international agreement between them relating to the avoidance of double taxation. In case of disagreement between Members as to whether a measure falls within the scope of such an agreement between them, it shall be open to either Member to bring this matter before the Council for Trade in Services. The Council shall refer the matter to arbitration. The decision of the arbitrator shall be final and binding on the Members."[246]

Additionally, footnote 11, attached to the provision reads as follows:

> "With respect to agreements on the avoidance of double taxation which exist on the date of entry into force of the WTO Agreement, such a matter may be

[244] See ABR, *Mexico – Taxes on Soft Drinks*, para 44, Mexico explicitly refrained from making the argument that the panel request under NAFTA constituted a legal impediment to the WTO Panel's exercise of jurisdiction.
[245] J Pauwelyn, 'How to Win a World Trade Organization Dispute Based on Non-World Trade Organization Law?: Questions of Jurisdiction and Merits' [2003] 37(6) Journal of World Trade 997 reviews this possibility. He find that a treaty granting exclusive jurisdiction to another tribunal would prevent WTO panels from exercising jurisdiction with respect to a dispute.
[246] GATS, Article XXII(3).

> brought before the Council for Trade in Services only with the consent of both parties to such an agreement."[247]

The guidance provided by Article XXII(3) might seem clear on first sight. Upon closer examination, however, the wording raises a number of questions. These issues can be classified as arising *ratione materiae*, *ratione temporis*, and *ratione personae*. All three will be analyzed below.

a. Issues *Ratione Materiae* – the Scope of an Agreement Relating to the Avoidance of Double Taxation

The commentary to the OECD Model Tax Convention notes that the "phrase 'falls within the scope' is inherently ambiguous".[248] This ambiguity is further complicated by the fact that the Agreement needs to *relate* to the avoidance of double taxation. It is proposed that the term 'relating' is a peculiarity of the English version of the text and should not be given to much weight. The equally authentic French and Spanish versions entirely omit the term 'relating' and strongly suggest the measure needs to fall within the scope of an international agreement for the avoidance of double taxation.[249] It remains to be determined, however, what the scope of such an agreement is.

Article XXII(3) should not be read as a blanket exemption of all measures that fall within the scope of an agreement that contains the words 'double taxation' in its title. If this were the case a member could essentially contract out of the NT obligation vis-à-vis certain other members. Equally, it appears somewhat restrictive to interpret Article XXII(3) generally not to apply to other agreements that contain a chapter on the avoidance of double taxation. At the minimum, alleged NT violations relating to measures falling within the scope of these provisions should be inadmissible under Article XXII(3). Thus, it appears that specific provisions of a DTA should be scrutinized within the context of the

[247] GATS, footnote 11.
[248] OECD Model Tax Convention, Commentary to Article 25, para 92.
[249] The French text of Article XXII(3) reads: "Un Membre ne pourra pas invoquer l'article XVII, que ce soit au titre du present article ou au titre de l'article XXIII, pour ce qui est d'une mesure d'un autre Membre qui *relève* d'un accord international conclu entre eux *pour* éviter la double imposition." [emphasis by author]; The Spanish version of the text reads: "Ningún Miembro podrá invocar el artículo XVII en virtud del presente artículo o en virtud del artículo XXIII con respecto a una medida de otro Miembro que esté comprendida en el *ámbito* de un acuerdo internacional entre ellos *destinado a* evitar la doble imposición." [emphasis by author].

agreement in which they are placed to determine the scope of said agreement. The different approach to DTAs under GATS XIV(e) above does not contradict these findings. The difference in wording between GATS XIV(e) and XXII(3) allows for the same DTA to be an 'international agreement on the avoidance of double taxation' under the latter and a 'other agreement or arrangement containing provisions on the avoidance of double taxation' under the former. To underline that the same or similar wording in different provisions does not always have the exact same meaning one only needs to think of the AB's interpretation of 'likeness' in *Japan-Alcoholic Beverages II*.[250]

It is generally agreed that DTAs have a number of aims, only one of which is the avoidance of double taxation.[251] It is possible to argue that, for example, "nondiscrimination rules do not deal with the primary goal of tax treaties to avoid double taxation". [252] Non-discrimination provisions, nevertheless, constitute "a common feature in many tax treaties."[253] Thus, a discriminatory measure should be excluded from WTO dispute settlement where it falls within the scope of the non-discrimination provision of a DTA. However, this situation is further complicated by the fact that the non-discrimination obligation of DTAs only covers cases of direct discrimination.[254] Hence, alleged cases of *de facto* discrimination may still be subject to WTO dispute settlement, as they do not necessarily fall within the scope of the DTA in question.

It may be argued that Article XXIII(3) exists as the dispute settlement mechanism under tax treaties constitutes the better-suited forum with regard to tax measures. The competent authorities directly engage in negotiations and may reach more suitable results in shorter periods of time than would be the case in adversarial WTO proceedings. Alternatively, the GATS provision was included to prevent WTO panels and the AB from interfering with the heavily

[250] ABR, *Japan-Alcoholic Beverages II*, p. 21.
[251] See, for example, S Van Weeghel, *The Improper Use of Tax Treaties: With Particular Reference to the Netherlands and the United States* (Kluwer 1998), pp. 33ff who finds that DTAs also prevent tax avoidance and discrimination.
[252] K van Raad, 'Nondiscrimination in Taxation of Cross-Border Income under the OECD Model and EC Treaty Rules – A Concise Comparison and Assessment' in H. van Arendonk and others (eds), *A Tax Globalist* (IBFD 2005), p. 137.
[253] Farrell, supra 94, p. 187.
[254] See OECD Model Tax Convention, Commentary to Article 24, para 1; L Friedlander, 'The Role of Non Discrimination Clauses in Bilateral Income Tax Treaties After GATT 1994' [2002] 47(2) British Tax Review 71, p. 80 notes "indirect or substantive discrimination of nationals does not violate the non-discrimination article [of a DTA] whereas formal or direct discrimination does."

guarded bastion of state sovereignty regarding direct tax measures.[255] In either case, a panel that assesses Article XXII(3) will inevitably face the question if it should adopt and inclusionary or exclusionary approach to direct tax measures. A restrictive or wide interpretation of the term 'scope' is warranted respectively. Part III below will review some of the broader issues relating to the appropriateness of income tax disputes in WTO dispute settlement. These arguments, though founded in law are not strictly speaking of a legal nature. The above sought to outline the limits of what is legally permissible under Article XXII(3). Where a panel or the AB ultimately draws the line will be in part informed by considerations exceeding the black letter of the law.

b. Issues Ratione Temporis – a DTA that *Exists* on the *Date of Entry into Force of the WTO Agreement*

The focus here is on the wording adopted in footnote 11 to Article XXII(3). As with all of Article XXII(3) there is currently no authoritative interpretation emanating from dispute settlement proceedings or otherwise. To recall, footnote 11 provides "[w]ith respect to agreements on the avoidance of double taxation which *exist* on the *date of entry into force of the WTO Agreement*" the question as to the scope of the agreement can only be submitted to arbitration with the consent of both states.[256] There are certain questions that arise in this context. Below it will be attempted to provide tentative answers.

First, footnote 11 only generically refers to the date of entry into force of the WTO Agreement. Generally, Article 24(3) of the 1969 Vienna Convention on the Law of Treaties (VCLT) provides "[w]hen the consent of a State to be bound by a treaty is established on a date after the treaty has come into force, *the treaty enters into force for that State on that date*, unless the treaty otherwise provides."[257] The last sentence of Article XIV(1) of the WTO Agreement in turn provides "[a]n acceptance following the entry into force of this Agreement shall

[255] It appears that the negotiating history would support this line of argument. Tax experts from the United States threated to let the GATS fail if direct taxes are included. See on this point RA Green, 'Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes' [1998] 23 Yale Journal of International Law 79, pp. 92f.
[256] GATS, footnote 11 [emphasis added].
[257] VCLT, Article 24(3) [emphasis added].

enter into force on the 30th day following the date of such acceptance."[258] Thus, it is conceivable that the date of entry into force of the WTO Agreement in footnote 11 means the date of entry into force between the disputing parties. In case either complainant or respondent acceded after 1995. The relevant date would, thus, be 30 days after the acceptance by that member as provided by the Protocol of Accession.

Such an interpretation could further be supported by the strong presumption against retroactive application of treaties.[259] However, this situation is somewhat different from a retroactive application since the WTO Agreement here does not apply to facts or acts of a state before its entry into force. Instead, the footnote provides for a cutoff date after which it is not necessary to have the consent of both disputing parties to refer the question of the DTA's scope to arbitration. The language adopted in the last sentence of Article XIV(1), cited above, indicates that in the context of the WTO Agreement, 'entry into force of the WTO Agreement' refers to the date the WTO was established, January 1, 1995.[260] To support this line of argument, the protocols of accession of new Members provide that "upon entry into force of this Protocol… [the country] *accedes* to the WTO Agreement".[261] They do not state upon entry into force of this Protocol, the WTO Agreement enters into force with respect to that state. Therefore, it appears consistent to understand 'entry into force of the WTO Agreement' to refer to its original entry into force and not the date the agreement became binding between the disputing parties.

Secondly, with regard to the question at what moment a DTA begins to exist, there are three possible points in time that could be referred to: signature, ratification or entry into force. Once a DTA's text is agreed upon and signed it

[258] Marrakesh Agreement Establishing the World Trade Organization (WTO Agreement), 1867 UNTS 154, Article XIV(1).
[259] United Nations Conference on the Law of Treaties, 30th Meeting of the Committee, UN Doc A/CONF.39/C.1/SR.30, para 4; See also ABR, *Brazil-Desiccated Coconut*, WT/DS22/AB/R adopted 20 March 1997, p. 15.
[260] WTO Agreement, Article XIV(2) adopts equally indicative language. Though the provision has no application in the current context it clearly indicates that 'entry into force of the WTO Agreement' is considered to be January 1, 1995 in the context of the covered agreements. The provision reads: "A Member which *accepts this Agreement after its entry into force* shall implement those concessions and obligations in the Multilateral Trade Agreements that are to be implemented over a period of time starting with the entry into force of this Agreement as if it had accepted this Agreement on the date of its entry into force." [emphasis added].
[261] See, for example, Protocol of Accession of Montenegro (17 December 2011), WT/L/841, para 1.

arguably exists. In fact, certain provisions of the VCLT relate to treaties that are signed but not yet ratified, strongly implying a treaty's existence as of the moment of signature.[262] However, if one considers the rationale for Article XXII(3) to be that a better suited dispute resolution forum than the WTO DSB exists for income tax measures, mere signature appears insufficient. At times the ratification process may take several years and there appears to be no good reason to bar access to WTO dispute settlement where the treaty has not yet been, and may never be ratified. Whereas the French version adopts the same ambiguous term,[263] the Spanish text strongly indicates the date of entry into force to be the date at which a treaty exists.[264] The term that has been utilized, 'vigente', can be translated with 'operative' or 'in force'. Thus, relying on the above rationale for Article XXII(3) and the equally authoritative Spanish version of the text, for the purposes of this provision DTAs 'exist' after their entry into force.

Thirdly, there is the question of agreements that existed before the entry into force of the WTO Agreement but have been heavily modified after. The OECD Model Tax Convention Commentary finds that the distinction between treaties concluded before and after entry into force of the WTO Agreement is inappropriate especially in light of later modifications of the DTA.[265] It seems to imply, thus, that a later modification may result in the treaty being considered different from the one that originally existed. Some countries disagree with this proposition. Canada and the United States, for example, are of the opinion that "a Protocol to a convention that is grandfathered under Article XXII(2) [sic], footnote 11, of GATS is also grandfathered."[266] However, it is unclear if a panel would defer to this position. In light of the proposed multilateral tax agreement

[262] See, for example, VCLT Article 18, the obligation not to defeat its object and purpose prior to entry into force, Article 24(4) which specifies that certain provisions of the treaty already apply prior to entry into force, or Article 25 concerning a treaties provisional application pending entry into force.
[263] The relevant part of footnote 11 stipulates: "Pour ce qui est des accords visant à éviter la double imposition qui *existent* à la date d'entrée en vigueur de l'Accord sur l'OMC …".
[264] The relevant part reads: "Con respecto a los acuerdos destinados a evitar la doble imposición *vigentes* en la fecha de entrada en vigor del Acuerdo sobre la OMC…".
[265] OECD Model Tax Convention, Commentary to Article 25, para 91.
[266] Fraser Milner Casgrain LLP, *Canada-U.S. Tax Treaty: A Practical Interpretation* (3rd edition, CCH Canadian Limited 2009), p. 163.

under BEPS Action 15 that will potentially heavily modify a large number of older DTAs, the question will only become more pressing in the future.

The fourth issue relates to the broader problematic of the applicability of outside law in WTO proceedings. The question is if a post 1995 DTA can specify that the disagreement as to its scope can only be settled by arbitration with consent of both parties, despite the language in Article XXII(3). The OECD Model Tax Convention provides in its commentary a model clause to that effect.[267] Earlier research found that some 90-tax treaties contain an override to GATS XXII(3).[268] One can imagine five possible scenarios how a dispute might proceed in the WTO.

Scenario 1: The matter is referred to the Council for Trade in Services. Although the Council does not seem to have discretion to refer the matter to arbitration, as indicated by the term 'shall', it acts by consensus and the respondent may block referral to arbitration. The scope of the DTA is, thus, not arbitrated. Even where the matter is referred to arbitration, the arbitrator may decline to rule based on the absence of consent of both parties. Essentially, the tax treaty clause is respected.

Scenario 2: The issue comes before an arbitrator who disregards the tax treaty clause and decides to have jurisdiction to determine the scope of the DTA, relying on GATS Article XXII(3). Depending on the arbitrator's decision, the dispute proceeds to the panel phase or the complainant is barred from invoking Article XVII.

Scenario 3: There is no determination of the scope of the DTA as either scenario 1 materialized or the parties never submitted the question as to the scope of the DTA to the Council for Trade in Services. The complainant nevertheless pursues

[267] OECD Model Tax Convention, Commentary to Article 25, para 93 provides: "For purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of Article 25 or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States."

[268] Farrell, supra 94, p. 212.

a ruling by the DSB. The DSB constitutes a panel, which declines to determine the scope of the DTA and does not proceed on the merits.

Scenario 4: Once again there is no determination as to the scope but a panel is instituted. The panel decides to determine the scope of the DTA itself. The panel either finds the dispute to be admissible and makes findings on the merits or decides the dispute falls within the scope of the DTA and the dispute cannot proceed to the merits phase.

Scenario 5: Again there is no determination as to the scope of the DTA and this time the panel refuses to rule on the scope itself. Instead it considers that there is no determination by an arbitrator that the dispute falls within the scope of a DTA between the disputing parties. In the absence of such a decision, the panel is not barred from proceeding on the merits following the logic of no decision is not a negative decision. The panel, thus, essentially disregards the DTA and a ruling on the merits of the dispute is possible. The panel's decision may, as in scenarios 4 and 5, be appealed to the AB.

The clear intention of such override clauses is for situation 1, and just situation 1, to materialize. In light of the above discussion on *Peru-Agricultural Products,* it is in line with the WTO Members sovereign rights and conceivable that this occurs. Even where one adopts a restrictive approach to any limits on the DSB's adjudicatory powers, where a dispute was initiated in the tax forum, the Members relinquished their rights to the settlement of that specific dispute by the WTO DSB. Nevertheless, in the absence of a determination by an arbitrator under GATS Article XXII(3) there is no guarantee that panel proceedings will not be instituted by the aggrieved party.

In scenario 4 the tax treaty clause is despite the disregard of the Members' expression of their sovereign will not entirely without effect. A decision by the panel on the scope of the DTA will be appealable to the AB whereas a decision by the arbitrator would be binding and final. Furthermore, a panel consists of three members and states may exert influence over the composition of the panel.[269] In arbitral proceedings the decision of a single

[269] See generally DSU, Article 8 on the composition of Panels.

individual will be decisive. In the context of DSU Article 21(3)(c),[270] where the parties cannot agree on an arbitrator, the Director-General will appoint an arbitrator.[271] According to the express language of GATS XXII(3), arbitration thereunder will equally be conducted by a single individual. Thus, disagreement as to the arbitrator is likely to ensue. Under DSU Article 21(3)(c) so far a former or active member of the AB serving in an individual capacity ruled in every single dispute.[272] With all respect to the members of the AB, none of them can be considered a tax treaty expert. So overall States may consider it beneficial to their case that the scope of a DTA is subject to a Panel decision as opposed to that of a single arbitrator.

Scenario 5, indeed, would be the worst possible outcome for the defendant as even disputes that may potentially fall within the scope of a DTA proceed on the merits in WTO dispute settlement. In this scenario, the inclusion of the tax treaty clause that sought to immunize a set of disputes from WTO proceedings may, in fact, achieve the opposite.

Overall there are many uncertainties surrounding these clauses contained in post 1995 DTAs. Because of the imbalance of the jurisdictional strength of the dispute settlement procedures in tax and trade, "[t]he power of attraction is almost entirely on the side of the WTO."[273] Though undesirable, it is quite possible that these tax treaty provisions will have no effect (Scenario 2) only result in the dispute as to the scope of the DTA being adjudicated by a panel instead of the arbitrator (Scenario 4), or potentially achieve the opposite of what they aim to do (Scenario 5). Perhaps for these uncertainties in conjunction with increased trust in the WTO dispute settlement system, "the majority of treaties, including more recent treaties, have not followed a restrictive approach that overrides the GATS guidance".[274]

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[270] DSU Article 21(3)(c) concerns the determination of a reasonable period of time for the implementation of the DSB's rulings and recommendations.
[271] See DSU, footnote 12 to Article 21(3)(c) which provides "If the parties cannot agree on an arbitrator within ten days after referring the matter to arbitration, the arbitrator shall be appointed by the Director-General within ten days, after consulting the parties."
[272] WTO, Arbitrations under Article 21.3(c) of the DSU, <https://www.wto.org/english/tratop_e/dispu_e/arbitrations_e.htm> accessed 19 May 2016.
[273] Kuijper, supra 180, p. 31 makes this observation with respect to multilateral environmental agreements and the WTO. However, it appears to hold equally true in the context of tax and trade.
[274] Farrell, supra 94, p. 212 [footnotes omitted].

c. Issues Ratione Personae – an International Agreement B*etween Them* Relating to the Avoidance of Double Taxation

This third difficulty arising under Article XXII(3) relates to the special case of regional integration organizations that are members of the WTO in their own right. Where these organizations have exclusive competence within the WTO to act on behalf of their members, currently only the EU, situations may arise where a tax treaty exists between one or more members of the regional organization and an opposing party in WTO proceedings. To highlight the difficulty in dealing with this issue the case of the international organization acting either as complainant or respondent will be viewed separately.

Taking a literal approach to the text of GATS Article XXII(3), where the EU acts as complainant challenging a direct tax measure of another WTO member, it is not barred from invoking the national treatment provision. There is no agreement on the avoidance of double taxation between the EU and any other WTO member. Thus, by its own terms, Article XXII(3) appears to be inapplicable where the EU acts as complainant.

The difficulty arises where another WTO member challenges a measure adopted by one of the 28 EU member states all of which are WTO members in their own right. Provided the complainant and the individual EU member have a DTA in force between them, it would be decisive if the complainant names the EU or the individual state as respondent. The United States, for example, concluded DTAs with all EU members but Croatia. Where the US wants to challenge an income tax measure adopted by Germany that falls within the scope of the tax agreement between them, it would simply name the EU as respondent. In areas where the EU has exclusive competence this approach would seem warranted. In *EC-Computer Equipment*, the US originally named Ireland, the UK and the EC separately as respondents.[275] The Commission argued that on basis of the "transfer of sovereignty within the internal legal framework of the EC" it should solely be held responsible.[276] Though the panel indicated the EC as sole

[275] The US requested consultations with the EC on 8 November 1996 and instituted additional proceedings against the UK and Ireland about four months later.
[276] Panel Report, *EC-Computer Equipment*, WT/DS62/R, adopted 22 June 1998, para 4.14.

respondent, it is unclear on what basis it did so.[277] The matter was clarified in *EC-Selected customs matters* where the Panel found that the authorities of the EC member states acted as organs of the EC.[278] Under Article 6 of the Articles on the Responsibility of International Organizations it appears correct to attribute the member states' conduct to the EU where its internal rules so provide.[279] The *EC-Trademarks and Geographical Indications* dispute was somewhat different.[280] At the time, the EU did not have exclusive competence with regard to trade related aspects of intellectual property. As the EU's members carried out a Directive, however, the EU's responsibility was accepted.[281]

Currently there is no explicit legislative competence of the EU in the field of direct taxation.[282] Nevertheless, there is a limited number of EU directives that were adopted on basis of Article 115 TFEU on the approximation of laws.[283] Thus, under current jurisprudence it appears where an EU member's actions are based on one of these directives it is appropriate to name the EU as defendant and circumvent the issue of Article XXII(3). Where the challenge concerns direct tax measures beyond the scope of these Directives, however, it is doubtful if the responsibility of the EU would be engaged. Article 6 of the Articles on the Responsibility of International Organizations could certainly not be taken as a basis. Furthermore, if the EU does not endorse its member's actions in the sense of Article 9 of the Articles, there is no basis to name the EU as defendant.[284] Hence, if panels approach Article XXII(3) consistently with prior jurisprudence, EU member states might avoid a national treatment challenge with respect to

[277] Ibid, para 8.16.
[278] Panel Report, *EC-Selected Customs Matters*, WT/DS315/R, adopted 11 December 2006, para 7.553.
[279] ILC, 'Draft Articles on the Responsibility of International Organizations' UN Doc A/66/10, Article 6(2).
[280] Panel Report, *EC-Trademarks and Geographical Indications*, WT/DS174/R, adopted 20 April 2005.
[281] PJ Kuijper, 'Attribution - Responsibility – Remedy: Some Comments on the EU in Different International Regimes' (2014) Amsterdam Law School Legal Studies Research Paper No. 2014-23 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2405028> accessed 8 June 2016, p. 10.
[282] European Parliament Directorate-General Internal Policies of the Union, 'The Impact of the Rulings of the European Court of Justice in the Area of Direct Taxation' IP/A/ECON/ST/2010-18, p. 14.
[283] TFEU, Article 115 empowers the Council to adopt laws where necessary for the establishment or functioning of the internal market. Currently in the area of income taxation there are the so-called Mergers Directive, the Parent-Subsidiary Directive and the Interest/Royalties Directive.
[284] Draft Articles on Responsibility of IOs, supra 273, Article 9 – Conduct acknowledged and adopted by an international organization as its own.

direct tax measures beyond the scope of the limited number of EU directives in this field.

Lastly, the situation of an international organization that acquires a competence with respect to income tax raises different concerns. If this organization now were to conclude DTAs and the individual members terminate their respective tax treaties, theoretically, Article XXII(3) should be applicable and a complainant would be barred from invoking GATS Article XVII vis-à-vis the organization. However, the complaining party could circumvent Article XXII(3) by naming the individual members as respondents with whom it does not have DTAs in force. Despite what has been said above with regard to the international organization assuming responsibility on behalf of its members, following the Panel's formalistic approach in *EC and certain member States-Large Civil Aircraft* this appears possible. The panel relied on the fact that the EC and its members are WTO members of their own right. The dispute concerned an issue in which the EU, then EC, had exclusive competence. Nevertheless, the panel held a number of member states additionally liable. It stated that "[w]hatever responsibility the European Communities bears for the actions of its member States does not diminish their rights and obligations as WTO Members".[285] This decision appears diametrically opposed to what has been found in other cases as explained above.

d. The Quantitative Reach of Article XXII(3)

This last section on Article XXII(3) considers its current reach in quantitative terms. Much will depend on the interpretation of the provision but where no tax agreement exists between the disputing parties the carve-out to the national treatment obligation cannot be triggered. Thus, it is worth having a look at the number of existing DTAs. An estimated 3000 plus tax treaties are currently in force. In all likelihood not all of them between WTO members but considering the large WTO membership of 162 states and territories presumably the majority of these DTAs has been concluded between members of the WTO.

[285] Panel Report, *EC and Certain Member States-Large Civil Aircraft*, WT/DS316/R, adopted 1 June 2011, para 7.175.

Ignoring the limited number of multilateral tax treaties, the total of 162 WTO Members results in 13041 bilateral relationships in which a WTO member could act as either complainant or respondent.[286] Thus, approximately one out of four bilateral relationships is covered by Article XXII(3). However, as indeed not every WTO member is equally active in dispute settlement it is necessary to consider the quantitative reach of the provision in more detail. As of the most recent dispute DS507 for which the Request for Consultations was received on April 4, 2016 a total of 103 WTO members have participated in dispute settlement proceedings in the capacity of complainant, respondent or third party.[287] As the tax treaty carve out does not apply to third parties, the focus is on the remaining 66 members that acted either as respondent or complainant. If one eliminates all WTO members that are only occasionally active in dispute settlement and instead focuses only on frequent users there are 29 states that are of interest.[288]

Mapping the bilateral tax treaty relationships between these 29 most active members, one finds that there are 406 potential bilateral relations. 185 of these bilateral relationships are covered by a multilateral or bilateral double taxation agreements.[289] This represents 45.57 percent of the bilateral relations of all frequent users. Put differently, Article XXII(3) is inapplicable in case of more than half of all potential dispute constellations among the WTO members that are most often involved in dispute settlement.

It is important to bear in mind that even if there is a DTA between two states, this only means that the treaty partner is barred from bringing a claim. There is virtually no WTO member that concluded DTAs with all other WTO members. Potentially there will, thus, always be a state that could bring a claim

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[286] The applicable formula is $\frac{n(n-1)}{2}$; when n=162 WTO members, $\frac{162*(162-1)}{2}$ = 13041.

[287] WTO, Disputes by country/territory <https://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm> accessed 7 June 2016.

[288] For the purposes of this paper frequent users are defined as states that acted as complainant or respondent in more than five disputes.

[289] This number includes tax treaties that have been signed but not yet ratified. Of the 185 taxation agreements in force between the frequent users, 60 have been concluded before 1995, 6 have been signed before 1995 but ratified after January 1, 1995, 103 have been signed after January 1, 1995, and currently 16 DTAs have been signed and ratified before 1995 but substantially modified after January 1, 1995. Especially this last number is expected to increase drastically in the following years on basis of the input created in the BEPS Actions.

for a violation of the GATS National Treatment provision. Considering the ease with which the requirements relating to *locus standi* are met in WTO dispute settlement it appears somewhat likely that one state brings the dispute and all other WTO members who would be barred under Article XXII(3) influence the outcome in the capacity of third-party. Therefore, it appears that most scholars greatly overestimate the extent of this tax treaty carve-out.[290]

iii. Overlap and the SCM Agreement

The SCM Agreement does not contain a carve out similar to Article XXII(3) of the GATS. Nevertheless, language can be found that directs WTO Members to settle specific disputes under existing bilateral tax treaties or other international mechanisms. The difficulties arise out of the terms employed as well as the location of this provision in the SCM Agreement. The above discussed footnote 59 relating to item (e) in the Illustrative List of Export Subsidies provides in its fourth sentence

> "In such circumstances the members shall normally attempt to resolve their differences using the facilities of existing bilateral tax treaties or other specific international mechanisms, without prejudice to the rights and obligations of Members under GATT 1994, including the right of consultations created in the preceding sentence."

The wording of the obligation appears somewhat weak. Furthermore, the scope of the provision is very limited as the fourth sentence refers back to the third sentence of footnote 59 by stating 'in such circumstances'. These circumstances are those where a member's administrative or other practices contravene the arm's length principle and result in a significant saving of direct taxes in export operations.[291] Hence, in observance of this requirement the US argued in *US-FSC* only with respect to its administrative pricing rules that an alternative forum should have been utilized.[292]

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[290] See e.g. Petritz, supra 23, p. 153 who opines that Article XVII has very limited impact due to Article XXII(3) and Article XIV(d).
[291] SCM Agreement, Annex 1, footnote 59 third sentence.
[292] ABR *US-FSC*, para 171.

Whereas others have wondered if footnote 59 presents an option to seek outside help or constitutes a mandatory requirement,[293] the EU in *US-FSC* took the clear stance that footnote 59 "is couched in hortatory language and it is left to the discretion of Members whether to resort to such alternative mechanisms."[294] However, one could also argue that that nothing about footnote 59 is discretionary. Merely because it provides for an obligation of means rather than result does not make its fourth sentence void of legal obligation.

The principle of effectiveness requires that the process of treaty interpretation may not reduce parts of an agreement to redundancy or inutility.[295] Thus, despite the lenient language one needs to ascertain the ordinary meaning of the terms in their context and in light of the treaties object and purpose. The ordinary meaning reveals that the provision imposes a mandatory legal obligation of means. Namely, that under normal circumstances members should make an attempt to settle their transfer pricing disputes in an appropriate forum outside of the WTO. Hence, footnote 59, indeed, directs Members to undertake this obligation. Unlike what the EC argued in *US-FSC*, it is not left to the discretion of the Member to decide whether to resort to such outside mechanisms. With the inclusion of footnote 59 in the SCM Agreement, WTO Members entered a binding legal obligation to attempt to solve their export subsidy related transfer pricing disputes in an appropriate forum outside the WTO such as the dispute settlement mechanism of a DTA.

To the uninitiated observer it may seem somewhat uncommon to find WTO obligations whose non-fulfillment cannot be sanctioned in WTO dispute settlement. However, this fact alone cannot deprive such obligations of their legally binding nature. In the context of the TBT Agreement, for example, a Member's failure to notify its proposed technical regulations to other Members is not backed by the same remedies as a failure to comply with the Agreement's non-discrimination provisions. Nevertheless, it would be absurd to argue that consequently the relevant provisions are not legally binding.

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[293] T Althunayan, *Dealing with the Fragmented International Legal Environment: WTO, International Tax and Internal Tax Regulations* (Springer 2010), p. 198.
[294] Panel Report, *US-FSC*, para 7.13.
[295] ABR, *US-Gasoline*, p. 23.

The absence of a specific remedy in case of non-observance admittedly does not induce Members to adhere to the obligation. To further its own case, the US attempted in *US-FSC* to give the fourth sentence of footnote 59 some teeth by arguing that a failure to comply with the footnote should lead the Panel to find the EU transfer pricing claim inadmissible. The Panel in *US-FSC* rejected this argument and observed that it "should not lightly infer a restriction on this right into the WTO Agreement".[296] It went on to find that non-fulfillment of this obligation does not restrict access to the WTO DSB.[297] The 'without prejudice' language contained in the footnote seems to affirm this reading.[298] Thus, despite the mandatory nature of footnote 59, non-observance does not disqualify a Member from having its dispute adjudicated by the WTO DSB.

To conclude on the procedural defenses that can be raised under the GATT, GATS and SCM Agreement with respect to income tax measures, it can be said that carve-outs where existent may not reach as far as some Member states' governments imagined. On the other hand, it is conceivable that Panels and the Appellate Body find WTO proceedings inadmissible in favor of the dispute settlement mechanism of the international tax regime, especially where compulsory arbitration exists. Current case law appears to permit application of general principles to that effect.

[296] Panel Report, *US-FSC*, para 7.17.
[297] Ibid, para 7. 18.
[298] That footnote 59 subsequently refers to rights under the GATT may be owed to the fact that this provision was carried over from the Tokyo Round Subsidies Code and is meant to refer to the WTO Agreement as stated by the US and EC in response to a question posed by the Panel in *US-FSC* (see para 7.19).

III. How Appropriate is it for the WTO to Adjudicate Tax Disputes

This last part takes a broader view on the substantive and procedural issues explored above and reviews arguments that exceed the black letter of the law. The aim is not to provide an exhaustive list of pro and contra but rather to analyze in some detail selected considerations that may ultimately influence Panels, the AB and WTO Members to favor an inclusionary or exclusionary approach to income tax measures.

A. The Deliberately Antilegalistic Nature of the MAP

The MAP is based on the competent authorities' willingness to solve cases of double taxation. There is no obligation to alleviate the problem in a specific case and the relevant provisions usually provide that the competent authorities shall "endeavour… to resolve the case".[299] On basis of Article 25 of the OECD Model Tax Convention three different types of MAPs can be discerned. The first is the so-called specific case provision, Article 25(2), which exists to solve a particular instance of double taxation.[300] The second type, the interpretative provision can be found in the first sentence of Article 25(3) under which the competent authorities endeavor to resolve abstract questions of interpretation and application of the DTA.[301] The third type, the legislative provision contained in the second sentence of Article 25(3), instructs competent authorities to consult with respect to cases of double taxation not provided for by the Convention.[302]

Tax arbitrations, for example, under the EU Transfer Pricing Arbitration Convention or Article 25(5) of the OECD Model Tax Convention only deal with the fact intensive disputes arising out of the specific case provision. The MAP was never intended to deal with questions of tax policy.[303] *A fortiori* states are reluctant to have such issues determined by an independent outsider. Hence, the question arises if it is appropriate for the trade regime to venture into the field of tax policy. In this context one quickly encounters the argument that income tax policy lies at the heart of the sovereign state. However, this statement could also

[299] OECD Model Tax Convention, Article 25(2).
[300] Ibid, Article 25(2).
[301] Ibid, Article 25(3) first sentence.
[302] Ibid, Article 25(3) second sentence.
[303] Green, supra 249, p. 103.

be made with respect to public morals,[304] environmental policies,[305] public health concerns,[306] or issues of national security.[307] Additionally, the *US-FSC* saga led to a major revision of US income tax legislation and although present, policy concerns did not bar the WTO from issuing a total of 7 reports. In fact, in a different context it has been noted that "environmental regulations constitute no less a sovereign prerogative than tax and finance."[308]

The argument that legalistic dispute settlement within the WTO may not be capable to take account of the intricacies of income tax rules also does not appear to be justified. It has been argued that the non-discrimination provisions of the WTO cannot be applied to direct taxes without qualification.[309] Non-discrimination is usually found on basis of nationality. However, there may be "important policy reasons that justify distinguishing between residents and non-residents when imposing direct taxes."[310] There appears to be ample space for such policy reasons in the general exception clauses under the GATT and GATS explored above. Furthermore, the AB in *Argentina-Financial Services* found that likeness under the GATS is more complex than under the GATT in light of the fact that the non-discrimination provisions apply to services and service providers.[311] Thus, it appears that the door has been opened for income tax legislation to distinguish between domestic and foreign service providers on basis of residence, as they are not necessarily like. Therefore, a general willingness to consider the complexities arising out of income tax measures appears to exist on part of the DSB.

Lastly, the availability of legalistic dispute settlement under WTO rules could induce a formerly unwilling party to engage in serious negotiations and

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[304] See, for example, ABR, *US-Gambling.*
[305] See, for example, ABR, *Brazil-Retreaded Tyres*, WT/DS332/AB/R, adopted 17 December 2007.
[306] See, for example, Panel Report, *EC-Hormones,* WT/DS26/R/USA, adopted 13 February 1998.
[307] See, for example Request for Consultations, *US-Helms Burton*, WT/DS38/1 (3 May 1996), which alleged that certain aspects of the US embargo against Cuba are in violation of WTO law. Although a panel was established in the dispute, the EC withdrew the complaint before a report was issued.
[308] WW Park, 'Arbitration and the FISC: NAFTA's Tax Veto' [2001] 2(1) Chicago Journal of International Law 231, p. 239.
[309] H Ault and J Sasseville, 'Taxation and Non-Discrimination: A Reconsideration' (2010) Boston College Law School Faculty Papers-Paper 286 <http://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?article=1290&context=lsfp> accessed 8 June 2016, p. 123.
[310] Ibid.
[311] ABR, *Argentina-Financial Services,* paras 6.38-41.

reach a speedy conclusion of a MAP. Equally the availability of an alternative forum may serve to bring issues to the forefront and increase debate leading to qualitative better outcomes.[312] Especially the former reason is analogous to the argumentation of binding tax arbitration enthusiasts. Tax arbitration may serve to increase the chances that the competent authorities reach a solution within the agreed upon time frame as otherwise, one of the parties may move forward with binding arbitration. Equally, the threat that one state may resort to WTO dispute settlement might increase the chances that both parties reach a legally well-founded, speedy solution.

B. Parallel Proceedings

With regard to parallel proceeding, these, indeed, may not only occur in the context of tax and trade. These may also arise, for example, where a measure is subject to an FTA or an environmental agreement in addition to the WTO Agreement. As parallel proceedings may contradict the idea of stability and certainty found in DSU Article 3.2,[313] it could be argued that the WTO should not encroach upon subject areas where the trade disputes arises incidentally and the measure could be dealt with in a more expedient manner under a different regime. However, as noted above, the tax regime merely provides very limited access to binding dispute settlement. It appears that dispute settlement under the WTO Agreement is preferable to the situation where both competent authorities fail to reach agreement and the dispute remains unsettled. It seems unlikely that one government would institute WTO proceedings while simultaneously being engaged in a diplomatic exchange that carries the impression of being conducive to the settlement of the dispute. Much more likely will be the scenario that one state resorts to the WTO DSB where a stalemate in the MAP materializes or the other party abandoned the procedure. The outright exclusion of direct taxes from the ambit of WTO dispute settlement may in turn prompt governments to circumvent the discipline imposed by the multilateral

[312] On how competing courts may lead to better outcomes for litigants and the limits thereof see JK Cogan, 'Competition and Control in International Adjudication' [2007] 48 Virginia Journal of International Law 411.
[313] DSU, Article 3.2.

trading system. It can hardly be argued that this would contribute to the aim of predictability and stability.

C. Third Party Participation

A third issue connected to the exclusion of direct taxes from WTO dispute settlement concerns the rights of third parties. Especially violations of the NT provision often concern the goods, services or service providers of multiple states that have an interest in the dispute. In the context of FTAs it has been noted that the exclusion of third parties under an FTA's dispute settlement mechanism may require other states to bring separate complaints in the WTO.[314] Similarly, where a discriminatory income tax measure finds challenge under a bilateral tax agreement, other WTO members are prevented from participating in these proceedings and may often not even be aware of their existence due to the confidential nature of the MAP. The participation of third parties, however, intends to ensures that two states do not make a bilateral settlement which "discriminate[s] against other members and undermine[s] the regime's cooperative multilateral equilibrium."[315] Thus, where complaints affect the interests of other WTO members it may be beneficial to settle such disputes in a multilateral forum. This multilateral forum does not need to be the WTO. It is equally conceivable that diplomatic means to solve disputes are employed in the OECD or UN. In the EU there have been some attempts to widen the scope of income tax arbitration under the EU Arbitration Convention to allow for multiple states to participate in the proceedings where this is conducive to or necessary for the settlement of a dispute.[316] Thus, it appears generally possible to allow for third states to participate more actively in the MAP. More research into the effect on the rights of third parties is required, however, to determine the necessity of access by third states especially with respect to income tax disputes.

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[314] J Hillmann, 'Conflicts between Dispute Settlement Mechanisms in Regional Trade Agreements and the WTO – What Should WTO Do' [2009] 42(2) Cornell International Law Journal 193, p. 204.
[315] ML Busch and E Reinhardt, 'Three's a Crowd: Third Parties and WTO Dispute Settlement' [2006] 58 World Politics 446, p. 447.
[316] The revised code of conduct provides for the solution of triangular cases. See EU Joint Transfer Pricing Forum, Final Report on Improving the Functioning of the Arbitration Convention (2015) JTPF/002/2015/EN.

D. The Absence of Tax Expertise in the WTO

Lastly it is necessary to review the purported absence of tax expertise among trade lawyers and vice versa.[317] The difficulty in establishing the Panel in *US-DISC* may be symptomatic of this problem.[318] Although it is generally not incorrect that few panels have "any knowledge or understanding of complex tax policy issues",[319] it does not appear impossible to identify such individuals and add their names to the indicative list of panelists maintained by the WTO Secretariat.[320] Interestingly, the very first case decided under the EU Transfer Pricing Arbitration Convention encountered similar difficulties to identify qualified individuals despite the Convention's narrow focus on transfer pricing issues.[321] This difficulty in identifying suitable Panelists is aggravated by the fact that only 14.2 percent of WTO Panelists come from the EU-28 and US.[322] This is largely due to both Members heavy involvement in WTO disputes. One can only speculate, however, it does not seem far-fetched to assume that a fair share of potential panelists who are considered experts simultaneously in tax and trade are US or EU-28 nationals. Nevertheless, this does not prejudge the appropriateness of the WTO as a forum to settle tax disputes, as even the

[317] HD Rosenbloom, 'What's Trade Got To Do With It?' [1994] 49 Tax Law Review 593,p. 593 who claims "there are few, if any, people who can claim knowledge, much less expertise, in both areas."

[318] JH Jackson, 'The Jurisprudence of International Trade' [1978] 72 American Journal of International Law 747, p. 762 describes the difficulties in finding tax experts over the course of two and a half years as the US insisted on their presence in the Panel. RE Hudec, 'Reforming GATT Adjudication Procedures: The Lessons of the DISC Case' [1987] 72 Minnesota Law Review 1443, p. 1464 additionally puts forward the explanation that the EC did not press forward in the dispute for political reasons. Thus, according to Hudec, if the political will would have existed a panel could have been established in less time.

[319] Farrell, supra 94, p. 138.

[320] DSU, Article 8.4.

[321] The so-called Electrolux arbitration between France and Italy was the first case to be decided under the Convention. Despite the AC's strict time limit, it took approximately one and a half years to constitute the Advisory Commission (the AC's term for the arbitral tribunal). See EU Joint Transfer Pricing Forum, Draft Summary Record of the Third Meeting of the EU Joint Transfer Pricing Forum (2003) JTPF/007/2003/EN, paras 11ff.

[322] J Pauwelyn, 'The Rule of Law Without the Rule of Lawyers?: Why Investment Arbitrators are from Mars and Trade Adjudicators are from Venus' [2015] 109(4) American Journal of International Law 761, p. 770.

participation of tax experts in the capacity of panelist is not a recipe for well-reasoned decisions.[323]

It is proposed, instead, that even in the absence of tax experts participating in WTO proceedings as panelists, the power accorded to panels under DSU Article 13 to appoint their own experts may be sufficient to reach a legally well-founded decision in complex tax disputes.[324] Furthermore, the adversarial WTO procedure allows the parties to the dispute to nominate experts to their own delegation. The lack of non-party experts in proceedings before the AB may partially be compensated by in-house expertise, if present, or *amicus curiae* briefs submitted by organizations with relevant expertise in the field of international taxation such as the OECD. Overall, therefore, the concerns relating to lack of expertise in the field of international taxation appear not entirely unfounded. Nevertheless, it is doubtful that such current lack of expertise could not be remedied through use of experts on part of panels and parties as well as *amicus* briefs. In the mid-term, it may well be desirable to include tax experts in the indicative list of panelists maintained by the secretariat.

Some Solutions by Way of Conclusion

This section concludes the above considerations and briefly offers some solutions to the problem of jurisdictional overlap between the dispute settlement mechanisms of the tax and trade regimes. This paper will refrain from proposing changes to the institutional set-up of the WTO or a revision of the WTO Agreement but instead focuses on existing provisions in WTO law and the apparently more flexible tax regime which currently undergoes a major revision.

First of all, panels and the AB may employ the substantive provisions of the GATT, GATS and SCM Agreement to dissuade states from challenging every income tax measure that incidentally falls within the ambit of the aforementioned agreements. The substantive exception clauses in GATT Article XX(d) and GATS Articles XIV(c),(d), and (e) allow for far-reaching policy

[323] Jackson, supra 312, p. 764 finds with respect to the *US-DISC* award in which two Panelists where tax experts that "the reasoning expressed in the conclusions of the Panel is opaque, questionable and incomplete."

[324] On experts in WTO proceedings see generally J Pauwelyn, 'The Use of Expert in WTO Dispute Settlement' [2002] 51(2) International And Comparative Law Quarterly 325.

considerations. Furthermore, the SCM Agreement's footnote 59 provides a carve-out for measures taken to avoid double taxation.[325] Generally, these provisions should ensure that only measures that in fact constitute subsidies and genuinely discriminate against foreign goods or services would be challenged. Clarification on the scope of these provisions by panels and the AB may be warranted to send clear signals to states.

Secondly, it is necessary to further formalize the interaction between the tax and trade regimes. Procedural carve outs such as GATS Article XXII(3) provide important tools in this regard. However, it is important that states do not challenge such carve outs in their DTAs. Such tax treaty provisions may, in fact, achieve the opposite of what they intend to do. Instead, states should seek to achieve acceptable solutions in income tax disputes, which, in the presence of clear language to that effect, could bar both parties from challenging the same measure in WTO proceedings. This way the WTO regime could assert a last resort role that ensures a genuine solution to income tax conflicts.

In line with this are the current efforts undertaken to strengthen the MAP and allow for binding tax arbitration. Where the tax regime provides the means to induce states to find acceptable binding solutions the WTO will not need to assume the role of a court of last resort. Disputes tend to be decided under the substantive rules of stronger jurisdictional system.[326] Thus, it appears imperative to strengthen the dispute settlement procedures under tax treaties to increase the power of attraction of the tax regime. In the widespread absence of binding tax treaty dispute settlement, it will be difficult to persuade a WTO panel that a better-suited forum exists. If the proposal for binding arbitration in tax disputes finds its way into the multilateral agreement developed under the OECD BEPS Action 15, a major step forward will be achieved in this regard.[327]

It is difficult to speculate as to the direction in which both regimes will develop. There are no signals that the WTO will not continue its business as usual. However, in times of growing awareness of the problem of base erosion

[325] SCM Agreement, footnote 59, fifth sentence.
[326] Kuijper, supra 180, p. 37.
[327] OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* (OECD Publishing 2015) provides a toolbox to develop a multilateral Agreement. At the time of writing the text of the Agreement, however, is unknown.

and profit shifting the number of income tax disputes in WTO dispute settlement will increase and measures may find challenge as in the recent *Argentina-Financial Services* dispute.[328] At the same time, there are indications that the strictly bilateral nature of the tax treaty system will slowly erode. In any case, it is doubtful that the trading system will make the network of bilateral tax treaties obsolete. In fact, bilateral tax treaties achieve objectives that the multilateral trading system is unable to deliver in its current state.

Overall, this paper attempted to provide tentative answers on the reach of the GATT and GATS non-discrimination provisions and their general exception clauses as well as the discipline imposed on income tax subsidies by the SCM Agreement. It has been argued that the substantive reach of these provisions with respect to income tax measures may go beyond the drafters' expectations. The discussion in part II on rivalry between the dispute settlement mechanisms of the tax and trade regime highlight the difficulties the far-reaching substantive scope of the three agreements may pose. Many of the issues that this paper sought to explore remain unsettled and clarification from within and outside the WTO DSB is needed to reach conclusive answers.

[328] Panel Report and ABR, *Argentina-Financial Services.*

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